S. HRG. 101–1074

CONSUMER ENERGY PRICE INCREASES

HEARING

BEFORE THE

SUBCOMMITTEE ON THE CONSUMER

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

THE EFFECTS ON CONSUMER PRICES OF RECENT MIDDLE EAST DISTURBANCES

AUGUST 7, 1990

Printed for the use of the
Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE

36–178 O

WASHINGTON : 1990

S261-25

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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CONSUMER ENERGY PRICE INCREASES

TUESDAY, AUGUST 7, 1990

U.S. Senate,
Committee on Commerce, Science, and Transportation,
Subcommittee on the Consumer,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:33 a.m. in room SH-420, Hart Senate Office Building, Hon. Richard Bryan (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Linda Moses and Moses Boyd, staff counsels, and Sherman Joyce, minority staff counsel.

OPENING STATEMENT BY SENATOR BRYAN

Senator Bryan. Good morning. Last Thursday the Iraqi armed forces suddenly and without provocation invaded Kuwait, plunging the world into a severe international crisis. Much is at stake, and the President has been meeting with his national' security advisers virtually around the clock. These are serious times; these are grave times, with many wondering if the United States will have to intervene militarily in the Persian Gulf.

Yet, while diplomats consult, military advisers draw plans, and the American people wait anxiously at home, others of the big oil companies have also been busy at work. The oil companies are taking advantage of the international tension by raising prices across the board. Even though there is oil in the storage tanks, even though there is gasoline at the pump and heating oil in the trucks, these giant corporations are plundering the American consumer.

Across the Nation, gasoline prices are going up. According to published reports, as of last Friday many of the big oil companies have substantially raised their prices since the beginning day of the Kuwaiti invasion. British Petroleum has raised its gasoline prices 7.5 to 9 cents per gallon; Chevron 5 cents; ARCO 5 cents; Mobil Oil increased its wholesale price last Friday by 3.5 cents.

In my own State of Nevada all of the principal suppliers have raised prices. In the New York area, gasoline prices have gone up as much as 15 cents, and Pennsylvania distributors have been told by their big oil suppliers that prices are going up 8 cents. Last night I had the occasion to visit with the Attorney General of that State, who reported to me that in some places in Pennsylvania the price had gone up 20 cents a gallon since the crisis began last Wednesday. In Georgia, suppliers have seen the price rise more than 17 cents. In Little Rock, Arkansas, gasoline prices have gone up 13 cents in just two days. In Florida, prices went up as much as 15 cents a gallon last week.

According to the American Automobile Association spot check of 1,400 service stations nationwide, gasoline prices on average have gone up 4 cents in two days last week, and yesterday the firm conducting these surveys for the AAA stated that since last Wednesday there has been an average of 11 cents per gallon increase across the board throughout the Nation.

The question arises, are these price rises the honest reflection of a shortage of fuel? The Department of Energy thinks the answer to that question is no. Last week Secretary Watkins, to his credit, put to rest any doubts on this score. On August 2 the Department of Energy issued a release, quoting, "Uncertainties in the Middle East pose no immediate threat to the supply of petroleum products for American consumers, nor do they necessitate increases in prices for American consumers."

The Department of Energy based this statement on the extensive data collected by the Energy Information Administration. The Department of Energy makes the point that, rather than a shortage, we actually have the highest stockpile of crude oil and product stock in the past eight years.

If supply shortages are not the cause of these price increases, one is left with the inescapable conclusion that profiteering is occurring at the expense of the American consumer. In their defense, the oil companies have argued that they have had to pay higher prices in the spot oil market. They have, but that is for oil that will not reach the pump until there is a nip in the air this fall and the leaves begin to turn colors.

Gasoline being sold on this summer day is based on oil prices well below the much-invoked spot oil prices that we are seeing in the evening news and reading about in the newspapers. When the price of oil on the spot market falls, we are told by the oil companies that there must be a lag time for the price to fall at the local filling station. Yet, when we witness an increase in the spot market, there is an immediate and painful increase at the pump to the American consumer. Apparently the laws of economics only work one way, against the interest of the consumer.

Certain regional economies like New England have already slipped into a recession. Inflationary and unjustified price increases such as the ones we have witnessed in the past week could cause a rippling effect to other regions in our country and cause a national recession. Yesterday, the United Nations, at the President's urging, voted for a comprehensive economic boycott of Iraq. The United States has led the charge to cut off the flow of oil out of Iraq. As a result of the Iraqi aggression, America may indeed face a reduction in oil supplies in the future.

That potential sacrifice in no way justifies the virtual thievery that we have seen take place over the last few days. Considering that this is a time of trial and tension only serves to highlight the unconscionable behavior of these corporate giants.

The administration, through Secretary Watkins' leadership, took the first step by indicating the falsity of the claims of oil shortages. It is a positive step and buttresses the efforts led by Senator Lieberman and others calling upon the administration to conduct an expensive investigation of oil pricing.

I am pleased that I have been joined here this morning by our distinguished co-panelist, the junior Senator from Massachusetts, Senator John Kerry.

Senator Kerry, welcome.

OPENING STATEMENT BY SENATOR KERRY

Senator **Kerry**. Thank you very much, Senator Bryan.

Senator Bryan, I would like first of all to thank you very much for holding this important hearing and I want to commend you for taking the leadership to try to get to the bottom of these price increases and to ask some of the tough questions that need to be asked.

Senator Lieberman, I thank you. I was pleased to join with you in the effort to ask the President to put together the Oil Price Task Force, which I think is most important, and I think your leadership on this is vital. I know you have formerly, as Attorney General, experience with this very problem and you are first in it.

As we come here this morning, obviously all of us are mindful of everything that is at stake in the Middle East and we are, all of us I think, supportive of the President's efforts thus far with respect to the foreign consequences of this crisis.

There is not anybody who was not heartened by the vote at the United Nations yesterday, and I do not think there is anyone who does not feel that his international diplomatic efforts have not been important and I think competent and helpful.

But there is a domestic side to this. Americans are prepared to face sacrifices, but they expect the corporate sector to be responsible, and they have a right to expect that the corporate sector is not going to take advantage of this kind of opportunity and take advantage of each and every one of us.

There is no question in my mind that in the last few days we have witnessed and extraordinary response to this crisis by the oil companies themselves, and as a result of that response forced onto the dealers at the pump price increases that are simply without justification.

According to a survey that was released yesterday by the Triple A prices at the pump have surged across the country by an average of 11 cents, and a 7 cents increase on Saturday and Sunday alone. Within hours of Iraq having moved into Kuwait, prices started up at the pump in this country.

Now, I know that the consumers in Nevada want answers to this. I can tell you that consumers in Massachusetts and Connecticut, where we already are in a recession, want answers to this.

How is it that gasoline which has already been paid for, which is sitting in a tank underneath the service station or sitting in a tank in Louisiana that was paid for previously, how is it that that gas goes up 11 cents in a matter of days? Someone is making a killing on this.

This does not represent a fair increase against the price of oil that Americans are going to pay somewhere down the road, nor does it, I think, represent a fair cost for the oil that is coming in even representing the spot market.

I think, given the fact that in the last few days the American consumer shelled out $157 million already in extra price for gasoline, which price does not represent the cost to the refiner, we have got a right to ask some tough questions and we have a right to expect that the administration is not only going to ask some tough questions but do some jawboning in an effort to try to see what we can do about these prices.

In the 1960s, when the steel industry did the same kind of thing in the wake of the price increases, after a very tough negotiating effort with labor. Steel raised, I think by about $6—the price of steel—and immediately President Kennedy went into action and there was some tough efforts with respect to the steel companies and within one day those prices were rolled back. It seems to me fair that the President ought to be asking the presidents of these companies to be as responsible with respect to this situation.

Mr. Chairman, last night I asked Dr. Allan Sinai of the Boston Company, who is one of the most respected economists in this country, what he thought this impact of sudden increase could be. He shared with me the results of an analysis that he has just completed of a model that he has run. I think it is the only one in the country. It is certainly the only one thus far run.

What he said is that an $8 a barrel price increase for oil on his model, assuming that other factors remain constant—and that $8 is just about exactly where we have gone, from a 21 point something to about a 28.05 where we closed last night—this is what happens:

In the next 12 months it would produce a .8 percent reduction in the growth of GNP in this country. That means that our tepid economic growth of today would be cut in half. It would produce a 1.2 percent increase in the Consumer Price Index. That means inflation would jump about 25 percent. It means a .2 percent increase in the national unemployment rate, which means, obviously, that there would be an enormous leap in unemployment in this country, which is frightening enough, but when you look at states like yours and mine, Senator Lieberman, it is even more imposing.

So, Mr. Chairman, the psychology of this increase and of this process of greed is, I think, a dangerous one. It raises questions about even patriotism and about the better interests of the economy of this country.

I think we have a right to expect that when the crude oil stocks are at the highest point they have been in 17 years, when we have a petroleum reserve that Americans have paid billions for in order to protect themselves against this kind of a crisis, there are some tough questions that ought to be asked, particularly when much of the oil represented by the 8 percent that Kuwait and Iraq represent to our market could be in fact replaced not only by Saudi Arabia and Venezuela and other countries, but by other sources.

I do not think we ought to be going through this negative impact, and I welcome the opportunity this morning to explore the rationale for it and to find out precisely what is happening.

Thank you, Mr. Chairman.

Senator **Bryan**. Senator Kerry, thank you very much for your participation. Those are indeed tough questions, and hopefully we will get some answers to these this morning.

I have opening statements from Senators Hollings, Exon, and Gorton, that I will introduce into the record.

[The statements follow:]

OPENING STATEMENT BY THE CHAIRMAN

Mr. Chairman, I agree with you that this hearing should be held on such an expedited basis, so that we can consider the effects on American consumers brought on by Iraq's invasion of Kuwait.

For far too long, we have known that America is dangerously dependent on foreign sources of oil. Recent events only reinforce that knowledge. The implications of that dependence are far-reaching, both from a foreign affairs as well as economic point of view.

A rise in the cost of energy, or in the cost of certain other goods and services, will mean further trouble on the economic horizon. The cost of transporting people and commodities is already starting to increase. The tourism industry and other industries will likewise be affected by rising gasoline prices. States like my own state of South Carolina, which depend heavily on tourism revenues, will certainly feel the effects of any such price increases. Ultimately, it is the consumer who bears the brunt of these cost rises. We see signs that our economy is at best stagnant, and rising prices will only aggravate our current economic situation.

The press accounts allege that price gouging is occurring. Many question whether recent events should be causing the price increases that we see. It is, therefore, appropriate that the Consumer Subcommittee investigate allegations that the rising costs are not justified. Through the testimony of the Federal Trade Commission, the Department of Energy and others we will be able today to see what efforts are underway to ensure that profiteering and opportunism are not occurring. I will review today's testimony, to determine if we need to formulate a response and take whatever action is necessary.

OPENING STATEMENT BY SENATOR EXON

Chairman Bryan, thank you for scheduling this hearing today of the Senate Commerce Committee's Consumer Subcommittee on the recent sudden price increases in gasoline and airline tickets, attributed to Iraq's invasion of Kuwait. I commend your leadership on looking into this important matter.

There are many questions about these recent sudden price hikes. As Chairman of this committee's Surface Transportation Subcommittee, I am also keenly aware of the impact sudden fuel price increases have on transportation costs and the major effect such increased costs have on our nation's economy.

In Nebraska, gasoline prices have already jumped by up to 10 cents per gallon at the wholesale level and retailers have increased prices by similar margins. According to the *Wall Street Journal* in an article yesterday, a 5 cent per gallon increase translates on a nationwide basis to $16.3 million a day, or about $5.9 billion per year that consumers won't have to spend elsewhere.

The immediate price hikes to consumers occurred only as a result of bad news, not as a result of any reduction in supply in Nebraska. While an eventual reduction in supply in Nebraska. While an eventual reduction in supply may lead to pressure on prices, it is obvious that these immediate price hikes appear only to be an attempt to make a fast buck at the expense of consumers.

The hysteria is not just in gasoline pricing. Airlines are now announcing surcharges because jet fuel has suddenly jumped. The crisis should not have affected the supplies we currently have in storage.

Again, thank you chairman Bryan for arranging this important hearing.

OPENING STATEMENT BY SENATOR GORTON

Mr. Chairman, I would like to thank you for holding this hearing today on the recent increases in gasoline prices. All Americans want to know if the prices they are paying for gasoline reflect the proper workings of the market or rather an effort by oil companies to gouge consumers.

Following last week's attack on Kuwait, Iraq now controls approximately 20 percent of the world's oil supply. As a nation, we import 50 percent of the oil we consume, and 8 percent of that comes Iraq. The result has been that wholesale gasoline prices have increased by as much as 7 cents per gallon in a matter of only days. Now consumers are facing higher prices at the pump.

Following the Exxon-Valdez accident, gas and home heating oil prices went up quickly, prompting substantial concern throughout the country. The same concern permeates the Congress and the nation as gasoline prices quickly rise in response to Iraq's actions in Kuwait.

Mr. Chairman, these developments in the Middle East will have a long-term impact on our energy policy. In the near term, however, oil companies may be treating American consumers unfairly by raising their prices before the market has a chance to work. Again, Mr. Chairman, I commend you for calling this hearing which will assist the Subcommittee greatly in determining whether consumers are being treated fairly. Thank you.

Senator BRYAN. Our lead-off witness this morning is Senator Joseph Lieberman from Connecticut. Senator Lieberman has long been active in this issue, relating back to the heating fuel crisis of last year, and recently took the lead by sending a letter to the President that 18 of his colleagues were pleased to join him with, including the two here who sit on the panel this morning.

Senator Lieberman, welcome. We would like to hear from you now.

STATEMENT OF HON. JOSEPH I. LIEBERMAN, U.S. SENATOR FROM CONNECTICUT

Senator LIEBERMAN. Thank you, Mr. Chairman and Senator Kerry. Mr. Chairman, I thank you particularly for convening this important hearing. I thank you for your leadership generally on behalf of the American consumer, and I thank you personally for inviting me to testify this morning.

Mr. Chairman, "simultaneous and identical actions of * * * leading corporations in increasing prices constitute a wholly unjustifiable and irresponsible defiance of the public interest. In this serious hour in our Nation's history when we are confronted with grave crises * * * the American people will find it hard, as I do, to accept a situation in which a tiny handful of executives whose pursuit of private power and profit exceeds their sense of public responsibility can show such utter contempt for the interest of Americans."

Mr. Chairman, those eloquent words that I have just read are not my own. They are the words of President John F. Kennedy, delivered 28 years ago on the occasion when the steel companies unjustifiably increased steel prices. Today, we are here to talk about an unjustifiable increases in the price of gas and oil.

It is important, as Senator Kerry has suggested, to remember President Kennedy not so much for what he said in April 1962, but for what he did. Faced with those sharp and unjustifiable increases in steel prices, and confronting international crises in Berlin and Southeast Asia, President Kennedy called in the steel executives and asked them—in the national interest—to roll back those price increases because a big steel price increase would cause inflation and hasten recession for America. He was right, and Big Steel agreed with him and within the next week rolled back those prices.

Mr. Chairman, what was true then is true today. The massive, instantaneous and unwarranted increases in gas prices since the

Iraqi invasion of Kuwait just 5 days ago not only brings terrible harm to American consumers, but threatens to throw this country into a full-blown recession as the impact of higher oil prices reverberates through our already shaky economy.

Already we see stock markets around the world in precipitous decline because of higher oil and gas prices. That is why I hope President Bush will follow the example of President Kennedy and tell the oil industry to do the right thing for America; tell the oil executives—in our national interest—to roll back prices immediately.

Mr. Chairman, as you know, I have also called on the President to create a presidential Oil Price Task Force, with representatives of the Departments of Energy and Justice, the Federal Trade Commission and the Commodity Futures Trading Commission, to investigate the rise in gas prices and report both to the President and Congress on what has happened, why it has happened and what we can do about it.

I am pleased that I have been joined by the two of you on the panel and by another 17 another of our colleagues, both Republicans and Democrats, in calling on the President to launch this investigation.

There is no doubt that in the last week America's consumers have been ripped off on a massive scale. At a time when the world is uniting to impose economic sanctions on Iraq, the oil industry of this country is plundering us just as Saddam Hussein has plundered Kuwait.

In fact, Mr. Chairman, it is a sad fact that the Soviet Union and China have done more to help America in the last week than our American oil industry. Consumers are paying $33 million more every day than they should be paying as a result of this profiteering at every level of the oil business: the major oil companies; the shippers; the transporters; the wholesalers; and, indeed, some of the dealers.

All of that price increase, in my opinion, is unjustified. As you and Senator Kerry have said, our stocks of crude oil are at record high levels, and the Department of Energy has acknowledged that there is no supply and demand reason for these gas hikes. Despite the fact that it takes at least 45 days—some say 60 to 90 days—for oil to come from the producing countries to the pump, price increases for consumers have traveled at virtually the speed of light in the last week. 24 hours after the tanks crossed the Iraq-Kuwait border, gas stations around America were hiking their prices to American consumers.

The reverse, we know well, does not hold true. In late 1985 to early 1986, the bottom dropped out of world crude oil prices. It fell from about $31 per barrel down to $15 per barrel. During that four-month period, the price of gas at the pump dropped an average of only 5 cents. I was Attorney General of Connecticut at that time, and I remember investigating that situation and calling in executives of the oil industry. They said to me, "be patient," it takes at least 45 days, maybe 60 or 90 days, for oil to come from the Middle East, so it will take time for the price decrease to work its way to the American consumer. I found, through the course of that investigation, that the reason its was taking so long for retail prices to drop was that at every stage of the process, from big oil company to wholesaler to dealer, there were people skimming off extra profits with hardly any benefit remaining for the American consumer from the worldwide drop in oil prices.

Now the oil industry has changed its tune, and the message they are giving us today is far different from the one they gave us in 1985 and 1986. Now they say it does not really matter how long it takes oil to get to us from the producing countries. What drives up prices now, they say, is the "expectation" of higher prices down the road. Mr. Chairman, that kind of Alice in Wonderland gibberish is making the American people understandably furious, and it is making our economy suffer.

If the oil industry refuses to respond to the public anger or presidential pressure, and the consumer continues to be victimized by what I would have to call price gouging, I think it will be time for Congress to consider more drastic action. Perhaps the time has come for what we might call economic sanctions against the American oil industry.

I intend to draft legislation to create a Federal anti-price gouging law that would allow us to prosecute companies that profiteer during times of national crises and which would give the Attorney General of the United States the power to go to court to seek not only damages, but restitution and rollback of prices for the American consumer.

After putting up with oil industry ripoffs in the 1970's, and as recently again as last winter, I think it is time to say enough is enough. It is time for us to act through the law and give the Federal Government the power it needs to protect American consumers in a time of national crisis. We have had enough of oil industry Mumbo Jumbo every time prices go up. When the American oil industry takes us to the cleaners, we need to have the authority to take them to court.

Connecticut and New York already have anti-price gouging laws on the books right now that can serve as models. The Connecticut statute begins with a declaration of an oil price emergency by the governor, and we could authorize the President to make a similar declaration.

I think, Mr. Chairman, that we will also have to consider tapping the Strategic Petroleum Reserve to cover any spot shortages that develop, to buffer the economy against the impact of long-term supply problems, and to eliminate any excuse by the oil industry that oil is in short supply.

We should also give serious consideration to creating regional reserves of stocks of gasoline and heating oil to counteract any artificial shortages or price increases. We suggested that last winter in the wake of the big hike in heating oil prices, which occurred, in my opinion, because the oil industry had very, very low, inadequate supplies and inventories of heating oil going into the winter heating season.

Mr. Chairman, none of us likes to support interference with the operation of our economy. We all believe in a market economy. Yet, when a market economy becomes a cover for consumers to be ripped off, when the economic freedom that the American economy offers is abused, then it is time to step in and protect consumers just as we step in and protect people, or attempt to protect people, from those who misuse their freedom in other areas of our national life.

As President Kennedy said in the speech from which I quoted before, "Price decisions in this country are and ought to be freely and privately made, but the American people have a right to expect in return for that freedom a higher sense of business responsibility for the welfare of their country than has been shown in the last two days."

Mr. Chairman, if the oil industry does not show a higher sense of responsibility for the welfare of this country than it has shown in the last five days, we in the Congress must act to pass laws to enforce that responsibility. I look forward to working with you and others in the Congress to make sure that happens.

Thank you very much for giving me this opportunity to testify.

Senator **Bryan**. Thank you very much, Senator Lieberman. We all look forward to working with you. Let me invite you, if you have the time to do so, to join us on the panel for a series of questions.

Senator **Lieberman**. Thank you, Mr. Chairman.

Senator **Bryan**. We have now been joined by the Ranking Member of the full committee, Senator Danforth. Let me yield to him for any opening comments he would care to make at this time.

OPENING STATEMENT BY SENATOR DANFORTH

Senator **Danforth**. Mr. Chairman, thank you very much. Thank you for convening this subcommittee on such a timely basis.

I think one of the most serious implications of what we have seen in the price of oil in the last few days is not simply the increase in the cost to the consumers but the fact that this has served as a distraction from what should be a total national focus and, indeed, worldwide focus on the assault by Iraq on Kuwait.

One of the heartening things that has happened is our country has become galvanized. This is not a partisan issue. Republicans and Democrats have been speaking with one voice, and indeed, the world has been speaking with one voice—witness the vote in the Security Council yesterday.

At a time when we should be focusing solely on the one bad guy in this act, we see that there is another villain on the scene. I think that what Senator Lieberman has pointed out is quite correct. When prices go up faster than is necessary, then it is not simply a matter of increasing prices. It is in fact, a distraction from what should be a total national and international effort to get Iraq out of Kuwait.

It may be, as Senator Lieberman pointed out, that additional legislation is required. My hope, however, is that we now have the legislative tools on the books to deal with the problem. I notice that this morning the Administration has taken the position that the Justice Department will examine closely the causes of the increased rise in oil prices. I would think that the antitrust laws are adequate to do the job. I hope they are. It may be that additional legislation is necessary. However, all of us in Congress know that if we wait for new legislation to be put on the books it can be a very long wait indeed.

Senator BRYAN. Thank you very much, Senator Danforth.

We have also been joined this morning by another member of the Committee, Senator Robb. Let me yield to you for any coents you would care to make at this point.

Senator ROBB. Mr. Chairman, I have no opening statement. I commend you on the timely convening of this particular panel. I share the concern that others have already expressed, and I look forward to hearing from our witnesses.

Senator BRYAN. Thank you very much, Senator Robb.

Our-first panel will consist of the Attorney General from the State of Rhode Island, the Honorable James E. O'Neil, and one of the members of the Federal Trade Commission, Andrew Strenio.

If I might get the Attorney General and the Commissioner to join us at this point, I would extend a welcome to each of them on behalf of the subcommittee, and as soon as they are comfortably seated we will begin, and hear from the Attorney General.

STATEMENT OF JAMES E. O'NEIL, ATTORNEY GENERAL, STATE OF RHODE ISLAND

Mr. O'NEIL. Good morning, Mr. Chairman. Allow me to begin by suggesting that it would be most appropriate, with the Chair's permission, I would like to incorporate by reference my prepared text and share with the Committee some informal thoughts that I think are appropriate for the morning.

Senator BRYAN. Without objection, General O'Neil, we will put your entire statement in as a part of the record.

Mr. O'NEIL. Thank you, Senator.

I would like to begin by thanking you, Senator Bryan, for inviting me here today and to commend you and your fellow committee members for your prompt response to this crisis that came upon us last week.

As you might recall, last winter, on January 16, 1990, I, joined by other Attorneys General throughout the United States, thanks to the efforts of your distinguished colleague, Senator Lieberman, had the opportunity to testify befoie the Senate with respect to the skyrocketing home heating oil prices.

I certainly appreciate the opportunity to return again, and I commend Senator Lieberman on his suggestion to the President that an Emergency Oil Price Task Force be initiated to investigate the unwarranted gasoline and oil price hikes.

As I say, I appreciate the opportunity to return, but unfortunately it is a very negative return on my part, because now we have the twofold problem of skyrocketing home heating oil prices and gasoline as well.

When I leave you with a few of the issues chat are on my mind and the mind of New Englanders, certainly I assume that all are aware that we are conscious of the fact that the price of a tanker load of oil as it arrives in port is actually set as a result of economic conditions as they are set abroad. In other words, that oil as it arrives in the United States, the price actually reverts back to and is set by conditions in the foreign areas of our world.

But I think it is important to recognize as I understand it that about 46 percent of our oil is imported and that our supplies right now are down only about 4 percent. Therefore, I think it is very fair to conclude that the prices which have skyrocketed out of sight have done so in a proportion that does not reflect the existing supply conditions, and therefore I, obviously, as you, wonder why. Some of the issues that Senator Kerry addressed in his opening statement are much on my mind also.

This monumental issue is one which obviously affects the pocketbook of young and old alike, and again I must wonder aloud how those on fixed incomes are going to survive and be in a position to survive and travel, adequately heat their homes, with the chill of fall upon us and the frost of winter soon to arrive. So the consequence of these events has yet really to be felt, the entirety of their impact.

On about half a dozen issues I was asked why I would travel to Washington to appear before this committee. I said essentially it is somewhat of a lobbying issue on my part, but I do not feel I need to do so with you gentlemen.

But I feel the issues we have to bring to the attention of the leadership include, did these refineries actually operate at capacity when the price was down? Down as low, I might point out, as the price of $16.50 a barrel in July of this year, being conscious that we are now, today, up in the area of $28 plus a barrel.

I also present the issue for others to consider that when the price of crude oil is down, do retail prices ever mirror that drop, and if not, why not?

It seems that external events conspire to drive the price up, and that that increase is immediately reflected at our gasoline pumps throughout the Nation or in the price of home heating oil as it arrives at one's home.

Also, I must wonder if there are sufficient oil reserve stockpiles when prices are down. Are we taking the steps that are essential to ensuring that we are gaining benefit from prices when they are low, as low as $16.50 a barrel?

Additionally, I ask you to consider the issue of whether or not there is any wisdom in utilizing any strategic oil reserves, and are those reserves sufficient perhaps not to be utilized today, but perhaps to be utilized in the future if a crisis of significant magnitude were to occur again?

Also, as a fifth issue, I ask us to think aloud as to whether there is a need to revisit the concept of industry regulation—just to revisit that concept.

I was pleased this morning to see that there was an article citing the fact that James Rill of the United States Department of Justice Antitrust Section has recognized the wisdom of the issue which resurfaced last winter, Senator Lieberman, at the hearings that you conducted, with respect to the concept of the Department of Justice conducting an investigation into price fixing.

Obviously, in my small State of Rhode Island our resources, due to the crime problem, are strapped to the maximum. We need the assistance of the Federal authorities, particularly the Department of Justice, to carry on an investigation of this magnitude. That investigation cannot be left to the States.

Clearly, it is one that is of national concern and multi-jurisdictional in nature. So it is appropriate for the United States Department of Justice or the Federal Trade Commission to step up to the plate.

And lastly, I leave you with the conclusion that I believe each of you share with me. The one fact that is clearly certain that when events, political and otherwise, benefit the oil industry, that industry clearly rises to the occasion, to the detriment of the consumer. But when events benefit the consumer, the industry is slower than slow to respond, and we must wonder why. Thank you.

[The statement follows:]

TESTIMONY OF JAMES E. O'NEIL

ATTORNEY GENERAL OF RHODE ISLAND

Senate Committee on Commerce, Science and Transportation,

Consumer Subcommittee

August 7, 1990

AS REPORTED IN THE NEW YORK TIMES MONDAY, "OIL TANKERS TAKE SIX WEEKS TO TRAVEL FROM THE EXPORT TERMINALS OF THE PERSIAN GULF TO THE REFINERIES OF THE GULF OF MEXICO, BUT OIL PRICES, AS EVENTS LAST WEEK HAVE SHOWN, MAKE THE TRIP AT SOMETHING NEAR THE SPEED OF LIGHT." (exhibit A)

HARDLY HAD THE FIRST IRAQI TANK CROSSED THE BORDER INTO KUWAIT LAST WEEK WHEN SIGNS IN GAS STATIONS IN RHODE ISLAND AND THROUGHOUT THE UNITED STATES BEGAN REFLECTING PRICE INCREASES. IN RHODE ISLAND, FAR REMOVED FROM KUWAIT AND WELL AT THE END OF ANY OIL PIPELINE, MID-GRADE UNLEADED GASOLINE ON AUGUST 6 WAS SELLING FOR AN AVERAGE OF $1.42 PER GALLON, A THIRTEEN CENT A GALLON INCREASE FROM THE AVERAGE RETAIL PRICE OF JULY 4 (exhibit B). I SUBMIT THAT THE MARKET FORCES THAT PRODUCED THAT INCREASE HAD LITTLE TO DO WITH SUPPLY OR DEMAND BUT MUCH TO DO WITH THE VAGARIES OF AN UNREGULATED MARKET.

THREE TIMES IN A LITTLE MORE THAN A YEAR WE HAVE WITNESSED THE OIL INDUSTRY TAKE ADVANTAGE OF EVENTS TO INCREASE PRICES: IMMEDIATELY AFTER THE EXXON VALDEZ INCIDENT IN ALASKA IN MARCH, 1989, DURING THE SHARP COLD SNAP IN THE NORTHEAST IN DECEMBER, 1989, AND MOST RECENTLY IN THE IMMEDIATE WAKE OF POLITICAL AND MILITARY AGGRESSION IN THE MID-EAST.

IN AT LEAST TWO OF THESE INSTANCES OF PRICE SPIKES, THE INCREASES HAPPENED WELL BEFORE ANY REAL FACTORS COULD HAVE AFFECTED THE ACTUAL LEVELS OF SUPPLY. EVENTS HAPPENED - AND PRICES WENT UP IMMEDIATELY.

IN ONE INSTANCE, LAST DECEMBER'S COLD SNAP, THE INDUSTRY HAD READY EXCUSES TO JUSTIFY THE SHARP SPIRAL OF HEATING OIL PRICES. AS I TESTIFIED BEFORE ANOTHER SENATE COMMITTEE IN JANUARY, "WE HEARD THAT THE COLD WEATHER IN THE GULF STATES CAUSED REFINERIES TO SHUT DOWN BECAUSE THEIR PIPES FROZE AND THEY HAD TO MAKE REPAIRS...THERE WAS ALSO THE EXXON REFINERY EXPLOSION AND FIRE IN LOUISIANA."

I AM CERTAIN THAT INDUSTRY REPRESENTATIVES WILL PRESENT TO THIS COMMITTEE EQUALLY PLAUSIBLE EXCUSES TO EXPLAIN THIS RECENT PRICE SPIKE. AS WE LEARNED IN JANUARY, THE INDUSTRY HAS ITS EXCUSES READY WHEN IT RAISES PRICES.

BUT, WHY DOES THE CONVERSE NOT HAPPEN? WHEN MARKET FORCES DEFLATE PRICES AT THE WHOLESALE LEVEL, WHY IS THERE NOT AN IMMEDIATE DECREASE IN RETAIL PRICES? IN JULY OF THIS YEAR, CRUDE OIL PRICES WERE 20 PERCENT LOWER THAN THEY WERE A YEAR

EARLIER (exhibit C). IN FACT, IN JUNE OF THIS YEAR, AS REPORTED IN THE WALL STREET JOURNAL, CRUDE OIL INVENTORIES WERE AT AN EIGHT YEAR HIGH (exhibit D). BUT CONSUMERS DID NOT SEE A CONSEQUENT DECREASE OF PRICE AT THE GASOLINE PUMP. THE INDUSTRY EXCUSE FOR THAT WAS THAT THERE WAS A LACK OF REFINERY CAPACITY AND THAT, REGARDLESS OF HOW MUCH CRUDE WAS AVAILABLE, NOT ENOUGH GASOLINE COULD BE PRODUCED TO BRING ABOUT A REDUCTION IN PRICE (exhibit C). SO, WE SEE THAT THE SCALES ARE ALWAYS TIPPED IN THE FAVOR OF THE INDUSTRY AND AT THE EXPENSE OF THE CONSUMER. SUPPLIES GO UP, BUT PRICES STAY UP. HOWEVER, WHEN SUPPLIES ARE MERELY THREATENED, PRICES GO UP ALMOST INSTANTLY.

THE LONG AND SHORT OF IT IS THAT WE ARE AT THE MERCY OF A CRITICAL INDUSTRY THAT IS WITHOUT CONTROL AND HAS NO ACCOUNTABILITY EXCEPT TO ITSELF. ON JULY 1, 1976 PRICE CONTROLS ON HOME HEATING WERE LIFTED. ON JANUARY 28, 1981, ALL PRICE CONTROLS WERE LIFTED ON ALL OIL PRODUCTS. A FREE MARKET ECONOMY EXISTS. SINCE THE REGULATIONS WERE LIFTED, WE HAVE ANTICIPATED THAT THE MARKET CONDITIONS THROUGH SUPPLY AND DEMAND WOULD CREATE SELF-REGULATING CONDITIONS. THE EVIDENCE OF THE LAST FEW DAYS, OF LAST WINTER, AND OF MARCH, 1989, IS THAT THESE SELF-REGULATING CONDITIONS HAVE SERVED THE OIL INDUSTRY VERY WELL BUT HAVE FAILED CONSUMERS MISERABLY. IT IS TIME THAT SOME FORM OF FEDERAL REGULATION OVER THE OIL PRICING STRUCTURE BE REVISITED.

THIS IS A CRITICAL INDUSTRY THAT LITERALLY FUELS OUR ECONOMY AND OUR LIFESTYLES. WE MUST HEAT OUR HOMES AND DRIVE

OUR CARS. THE DRAMATIC INCREASE IN GASOLINE PRICES AND HOME HEATING OIL PRICES CAN ONLY SERVE TO CREATE FURTHER FINANCIAL HARDSHIPS, IN MANY CASES FOR THOSE CONSUMERS AT THE END OF THE PIPELINE WHO CAN LEAST AFFORD IT. LET US KEEP IN MIND THAT ANOTHER WINTER HEATING SEASON IS JUST A FEW SHORT MONTHS AWAY.

MOREOVER, IN LIGHT OF AN ALREADY DECLINING ECONOMY, PARTICULARLY IN THE NORTHEAST, THE PRICE INCREASES OF THE PAST SEVERAL DAYS ARE TRULY FOREBODING. WITH FUEL PRICES, SO GO TRANSPORTATION PRICES AND A CONSEQUENT SQUEEZE ON INDUSTRY. ALREADY AIRLINES HAVE TACKED ON SURCHARGES TO REFLECT AND ANTICIPATE FUEL PRICE INCREASES (exhibit E). WE CANNOT AFFORD TO LET THIS CRITICAL OIL INDUSTRY REMAIN UNCHECKED.

I HAVE JOINED MY COLLEAGUE, ATTORNEY GENERAL JAMES SHANNON OF MASSACHUSSETTS IN ASKING THE U.S. DEPARTMENT OF JUSTICE TO CONDUCT AN ANTI-TRUST INVESTIGATION OF THE OIL INDUSTRY. I WILL WORK CLOSELY WITH MY FELLOW ATTORNEYS GENERAL TO MOUNT A COORDINATED MULTI-STATE APPROACH TO THE OIL PRICE ISSUE. ULTIMATELY, HOWEVER, THE ANSWER LIES WITH THE FEDERAL GOVERNMENT. I BELIEVE THAT CONGRESS SHOULD TAKE THE APPROPRIATE STEPS AND REVISIT THE QUESTION OF OIL INDUSTRY REGULATION.

JOSEPH A. STANISLAW OF CAMBRIDGE ENERGY RESEARCH ASSOCIATES WAS PARAPHRASED IN THE NEW YORK TIMES AS SAYING, THAT, "WHEN CRUDE PRICES ARE DECLINING, THE PRICES SEEM A BIT 'STICKY' OR SLOW TO MIRROR THE DROP." I SUBMIT TO YOU THAT, CONVERSELY, WHEN EVENTS CONSPIRE TO MOVE PRICES UPWARD, THE

INDUSTRY IS VERY QUICK TO RESPOND. THE EVIDENCE INDICATES THAT THE OIL INDUSTRY IS A SLICK INDUSTRY THAT CAN RISE TO THE OCCASION WHEN EVENTS BENEFIT IT BUT IS SLOW TO RESPOND WHEN EVENTS MAY SERVE TO BENEFIT CONSUMERS. THE TIME TO ACT IN THE INTEREST OF CONSUMER PROTECTION IS NOW.

American Automobile Association
of Southeastern New England
August 6, 1990

GASOLINE PRICE SURVEY

July 4

Full Service	Reg. Unleaded	Midgrade	Premium
	$1.22	$1.29	$1.38
Self Service	$1.10	$1.21	$1.28

August 6

Full Service	$1.33	$1.42	$1.46
Self Service	$1.17	$1.27	$1.34

Difference July 4-August 6

Full Service	Reg. Unleaded	Midgrade	Premium
	Up 11 cents	Up 13 Cents	Up 8 cents
Self Service	Up 7 cents	Up 6 cents	Up 6 cents

(Exhibit B)

Senator BRYAN. Thank you very much, General O'Neil.

We will next hear from Mr. Strenio.

STATEMENT OF ANDREW J. STRENIO, JR., COMMISSIONER, FEDERAL TRADE COMMISSION

Mr. STRENIO. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Subcommittee, I am here today at your request to respond to questions you have concerning the widely-broadcast reports of gasoline price increases following Iraq's invasion of Kuwait. My presence here is in my capacity as an individual member of the Federal Trade Commission. Accordingly, my comments and responses to your questions reflect my own views, and not necessarily those of the Commission, nor any of the other four commissioners.

As a commissioner of a federal agency responsible for protecting the public against unfair methods of competition, as well as unfair or deceptive acts or practices, I am very sensitive to the questions that already have been raised about these price hikes. Further, as a consumer confronted with increased gasoline prices at the pump, I also share the subcommittee's concerns on a personal level.

Thus, I am pleased to inform you that FTC staff is closely monitoring the situation. As you know, the Commission has a group of staff experts who have actively reviewed many aspects of the petroleum industry over the years. Staff's expertise has been accumulated through scrutiny of a number of specific mergers and acquisitions, and also through general economic analysis of the industry.

Given this expertise and current activity, and based upon my discussions with senior management, I am certain that FTC staff will continue to pay very close attention to the events of recent days and their effects on consumers. At first blush, I must say that the events over the past several days have created a new set of complex conditions that continue to change even as we speak. Because of this, I am not now in a position to offer any definitive answers as to what caused the rapid gasoline price increases reported since last Thursday's invasion.

As a theoretical matter, there could be a number of reasons for the retail gasoline price hikes. On the one hand, it is possible that the price hikes could be the result of a conspiracy to fix prices or other anticompetitive activity. Such a theory could account for a rapid price rise.

On the other hand, the recent gasoline price increases could well be the result of a normal market response to underlying demand and supply pressures. After all, economic theory predicts that prices are likely to increase quickly after a sudden drop (or expectation of a sudden drop) in the supply of a commodity—such as petroleum—if demand for that commodity remains constant.

At this time, I am informed that FTC staff is monitoring all areas of possible anticompetitive activity, but has not to date uncovered any evidence of a pattern suggesting that the price hikes are the result of price-fixing. However, if such evidence does exist, I expect that the Commission staff will find it, and recommend vigorous prosecution if the evidence holds up under examination. If you know of such evidence, I encourage you to bring it to the attention of the Commission or the Department of Justice. At the Commission, I respectfully would request that any evidence be brought to the attention of Kevin Arquit, who is the FTC's Director of the Bureau of Competition.

Mr. Chairman and Members of the Subcommittee, I will do my best to answer your questions today. However, please bear in mind that because this is such a new and rapidly changing situation, for now the supply of thoughtful questions is likely to exceed the supply of answers that can be provided with any degree of confidence.

Thank you, sir.

Senator **BRYAN**. Thank you very much, Mr. Strenio.

Attorney General O'Neil, let me ask you the first question, if I may. And that is, what actions, other than those that you have discussed and are included in your prepared statement, are the attorneys general taking to address this problem in their respective states?

Mr. **O'NEIL**. Well, essentially, Senator, what we have done is joined together to bring the issue to the attention of the Congress and the Federal Government. There are certain attorneys general who do have a greater capacity to initiate an antitrust measure. But I must say that yesterday Attorney General Shannon of Massachusetts, joined by other attorneys general throughout the Northeast, Preate of Pennsylvania, Amestoy of Vermont, and others from New England, did communicate with the Department of Justice. As I indicated, Mr. Rill has agreed to commence with an investigation.

So what we are doing is we are really using our collective force to urge the United States Department of Justice to, as I say, step up to the plate and be counted.

Senator **BRYAN**. In Senator Lieberman's testimony, he mentioned the fact that in some states, state legislatures have enacted price gouging statutes. If you have one in Rhode Island, tell us how it works, and has it been effective? And if you do not, do you know what the experience has been with other states that have such statutes?

Mr. **O'NEIL**. Quite frankly, I cannot speak to the experience other states have had, Senator. And in Rhode Island, we do not have an effective one on the books. But there has been momentum, as of yesterday, initiated by certain members of our general assembly. And I have spoken with Representative Brian Kennedy, for example, Senator Sholes, and others, who have said perhaps we should reconvene the general assembly to address this issue promptly.

And if that be the case, I think one of the first orders of business should be to take up the concept of developing an effective price gouging statute. So that is going to be one of the first orders of business if they do reconvene.

I might say, on Thursday of this week, I will be holding a conference with all the respective members of the oil industry in the State of Rhode Island, and representation from throughout New England as well. So we are trying to identify the issue as it impacts us on the consumer level and also on the dealer's level as well.

I might say, Senator, too often it seems we are prone to point immediately to the dealer who delivers your home heating oil or at the gasoline pump. And the problem obviously goes far beyond that neighbor of ours who is engaged in such business.

Senator **Bryan**. Thank you very much, Mr. O'Neil.

Mr. Strenio, we understand that you are speaking as an individual and not on behalf of the Commission, but what jurisdiction do you have to conduct an investigation in the first instance and to make a finding in the second instance of collusive practices which may violate the antitrust laws?

The second question I would have is, assuming for the sake of argument, but not conceding, that there is no collusive activity that would be prohibited as such under the antitrust laws, do you have jurisdiction under your unfair trade practice provisions, section 5 of the PTC Act, to take appropriate action?

Mr. **Strenio**. Senator, those are excellent questions, and let me endeavor to answer them as succinctly as possible. Neither answer is simple.

As to the Commission's authority to investigate for collusive behavior or other antitrust violations, the Commission does have extensive authority under section 5.

In a nutshell, the way the process works is that our staff analyzes the information that it is able to uncover or that is provided both from its public sources and from contacts within the industry. If the staff finds evidence suggesting that antitrust violations are a plausible explanation for the price hikes, staff can request and obtain authorization from the Commission to use subpoenas that would seek documents or testimony from the responsible officials within the industry.

Following the investigation, the staff would make a recommendation to the Commission. If they thought the evidence was there, they would recommend the Commission commence an administrative proceeding against the company or companies involved. Speaking solely for myself, I am quite confident if staff has a solid case that the Commission would look closely and if it had reason to believe these were antitrust violations, it would indeed commence such an action.

Following the commencement of an action, the Administrative Law Judge would hear the case and would render an initial decision. That decision is appealable to the full Commission, which would then issue its opinion. That opinion then may be appealed in the Circuit Courts of Appeal and up to the Supreme Court.

Following completion of the review process, if the Commission found liability and issued a cease and desist order, the order would take effect against the company or companies, and any violation of that order would be subject to a $10,000 civil penalty per violation.

The situation is one where our staff is in close contact with staff at the Department of Justice. Which agency investigates or prosecutes a matter depends upon the nature of the antitrust violation uncovered if any—if it were price-fixing or something similar where criminal action was indicated, the Department of Justice has criminal authority and we do not. So if criminal action were indicated, we might well yield our investigation to the Department of Justice for that appropriate penalty.

Switching very briefly to the other aspect of your question in terms of the Commission's authority to act if what is occurring is something other than a violation of antitrust law, the Commission does have broad unfairness jurisdiction under section 5, as you pointed out, Mr. Chairman, and the Commission has enumerated a fairly detailed test as to whether some other activity would run afoul of those unfairness criteria.

The Commission has generally required in those circumstances that there be evidence of some type of market failure. The Commission is not in the business in general of being a price regulatory agency as such. But, if there is evidence of market failure and the other unfairness criteria are met, it is possible that there may be some form of activity warranted. However, any decision on this would depend very much upon the specific facts. Given this very early stage, I could not begin to hypothesize whether the facts would be up to that level or not.

Senator **Bryan**. Mr. Strenio, my time for questions has expired, but I have just one last question. Has the Commission begun an investigation, an inquiry or probing of any kind into the circumstances which bring us here together as a subcommittee this morning?

Mr. **Strenio**. Senator, the Commission itself has not formally initiated an investigation. The process at the Commission, the way it works generally, is that staff is responsible for actively monitoring this industry. The Commission views the fuel area as one of such importance that one of our five litigating shops in the Bureau of Competition has responsibility solely for the fuel area and the food area.

Since my conversations with your staff and Committee staff over the last day or so, I have met with our senior managers, and I am assured that FTC staff is at present very thoroughly looking at what is out there to see whether there is sufficient indication of illegal activity to come to the Commission and request subpoena authority.

Senator **Bryan**. Thank you very much, Mr. Strenio. We appreciate your testimony.

Let me yield now to Senator Kerry for questioning.

Senator **Kerry**. Mr. Strenio, let me ask you and Attorney General O'Neil, my friend from Rhode Island whom I am glad to welcome here, these questions.

Mr. **O'Neil**. Thank you, sir.

Senator **Kerry**. You know, as I sit and listen to you, I kind of react the way some people reacted to me in Massachusetts yesterday when I was talking about this. They say, hey, you guys always go through the same exercise. There is going to be a hearing, you are going to have a hue and cry, people are going to stand up and pontificate, there is going to be a lot of hype about the price increases, but we are still going to get stuck with it, and we are still going to pay it, and in the end it is not going to roll back and nobody is going to do anything.

Now I hear the FTC talking about staff is looking at it. I know you are not here formally representing the FTC. The Attorney General has already articulated a kind of powerlessness by resource restriction and so forth.

Americans have already spent $157 million that they should not have spent, and if that is going to continue day to day I do not think they want to hear a lot of politicians just yelling about it. People want to see something done about it.

Now from your perspective, Mr. Attorney General, what is the most effective thing that can and ought to be done today and tomorrow to try to have an impact on this so that we are not in one of these circuses where people still wind up being frustrated and angry?

Mr. O'NEIL. Senator Kerry, Senator Lieberman has proposed giving thought to the concept of rolling back prices much as President Kennedy did with the steel prices, and I think that that thought should be thoroughly explored. If we are saying what can we do today, clearly that is something that the President could take the initiative to do. Obviously you want to give it considered thought beforehand. That would be recommendation number one, that we give that concept considered thought.

Senator Kerry, I obviously admire your candor with me and with the Nation that consumers do not want to simply talk about it. They would like to have some results as a result of our joining together. When I think about what has happened in the past 18 months with the *Exxon Valdez* and then the winter weather crisis and now with the situation in Kuwait, every time one of those events occurs, whether it be some sort of meteorological magic or Middle East magic, the oil industry seizes the moment to gouge the consumer. Now we have to pierce through that.

Senator KERRY. Do you think we have pierced through it?

Mr. O'NEIL. Absolutely not, no. I would say that in the last year I remember sitting side by side, I think, with Mr. Rill or at least behind him and listening earnestly to determine whether or not the Department of Justice was going to step up and be counted, as I say. Only today did I read that now they have agreed.

I am wondering in retrospect whether if they had not taken the aggressive posture that Senator Lieberman and you gentlemen urged upon them last winter if we would be in this position today.

There is a need for Federal intervention. There is a need for executive leadership. When I say "Federal intervention", it is no different than analogizing this situation with the war on drugs, with which you are intimately involved, Senator Kerry. I think it is $9.1 billion going for the war on drugs, with $850 or $650 million coming to the States. How can I with 6,700 felony crimes coming into my department take up a sophisticated issue such as this which is international in scope, let alone national?

To my brother from the Federal Trade Commission, I certainly appreciate his candor because he did say that the staff is monitoring the fuel industry, and he did say that they could then go to the Commission to seek subpoena power, I believe it was. Let us do it.

Senator KERRY. I appreciate the candor of your response. Let me ask him about that.

Did the FTC investigate the energy price run-ups in the aftermath of the *Exxon Valdez* accident?

Mr. STRENIO. The FTC staff has looked at those activities, yes.

Senator KERRY. And there was a winter heating oil run-up as a consequence, correct?

Mr. **Strenio**. That is correct.

Senator **Kerry**. So we ran through two run-ups. What are the findings that they came out with on that?

Mr. **Strenio**. Staff in both instances essentially concluded that there was not evidence that what had occurred was the result of anticompetitive, illegal activity on the part of the oil companies.

Senator **Kerry**. So did they conclude whether or not it was the result of actual marketplace forces that were legitimate?

Mr. **Strenio**. They were of the opinion that that was essentially a market response, rather than anything that would be subject to antitrust enforcement, yes, sir.

Senator **Kerry**. Can you explain to us from your perspective what the legitimate market force would be for an 11-cent increase on gas at the pump within a couple of days of Kuwait, which represents 1-point-some percent of the oil to this country, being taken over.

Mr. **Strenio**. Senator, I want to be very careful in my response here, and I trust you will understand that the reason I want to be so careful is because in my capacity as a commissioner, at some point down the road I may be sitting in judgment as to whether or not there is a case, or whether or not to bring a case. And I want to be very careful not to say something one way or another that is going to make me run afoul of prejudgment concerns or other considerations that are appropriate to someone in my position.

What I can say, speaking entirely in the hypothetical, is that you articulate a set of circumstances that could be explained by collusive activity, or it could be explained as a market response by people dealing with futures prices and expectations, responding to a situation where the supply is suddenly cut by approximately 5 percent, and great uncertainty as to what will happen next in the Middle East. And all that could drive this kind of response.

I am not by any means here to suggest that one answer or the other is the correct answer. And I am not here to defend or condemn any particular activity unless or until I have a full set of facts.

Senator **Kerry**. Fair enough. The red light is on and there are other senators who wish to ask questions. But I would just like to point out one thing with respect to that. I do not think that you are limited to just those two variations. The conspiratorial theory, certainly I do not think anybody is going to expect you are going to find overt evidence of price fixing or anti-competitive activity. But there is a rule around that most people have become pretty aware of, that when the crunch comes, the price goes up fast, and when it recedes, the prices rarely if ever come down as fast, if at all.

It is the old "refiners always win" rule. And I suspect that, given that, when given the opportunity, there is an almost automatic set-in, spontaneous reaction. It does not take a conspiracy. It does not even take a phone call. The time is here, raise, boom. We are going to raise the prices, and bang. You can find the ready excuse. Oh, it is the spot market, oh, it is the hedge against the future, or whatever. And it is sort of an automatic happening, which is a midline thing that does not fall into either of the categories that you have described.

Mr. **Strenio**. Senator, you raise an excellent point, and I did not mean to suggest that the issues that are appropriate to look at are limited to just those examples that I have suggested. Indeed, another area that is a standard one to examine is whether the price hikes were caused by the illegal exercise of market power, again raising prices above the competitive level. This is another area that is indeed a proper subject of inquiry.

I am simply saying that, as law enforcement official, I need to be very careful in walking these lines.

Senator **Kerry**. I appreciate that. I have used up my time.

Thank you very much, Mr. Chairman.

Senator **Bryan**. Senator Kerry, thank you very much.

Senator Danforth.

Senator **Danforth**. Mr. Strenio, is there in any agency or department or anywhere in the Federal Government that has the legal authority to roll back prices just because prices are believed to be too high?

Mr. **Strenio**. Senator, to my understanding, there is no current Federal price control authority of that nature. If an agency thought that the price was too high, even though it simply reflected a market response, there is no current legal authority to change those prices.

Senator **Danforth**. That would be a regulated system if we had that kind of authority.

Mr. **Strenio**. Yes, sir.

Senator **Danforth**. But under the present economic policy of the country, as a general rule, the Government just cannot order that prices get rolled back.

Mr. **Strenio**. We moved away from the price regulation system in the late 1970's. And that system had a number of difficulties associated with it.

Senator **Danforth**. Now I take it that if there is a finding of collusion, conspiracy, or violation of antitrust laws, under those circumstances, a court or maybe the FTC would have the authority to take whatever remedial action is necessary to deal with the problem. But there would have to be a finding of causation. It is not just the increase of prices, but it would have to be some finding of a conspiracy, would it not?

Mr. **Strenio**. Yes, sir, there would need to be a violation of the antitrust or section 5 statutes as a predicate for ordering some form of relief. As to the precise form of the relief, that is another question that has some very interesting facets. But there is the predicate of a judgment that there has been a law violation before we get to that.

Senator **Danforth**. Well, I am curious, Mr. O'Neil, about your recommendation. You say that the President should just take the lead in rolling back the price. How would he do that in your view?

Mr. **O'Neil**. What I did say, Senator, the suggestion as I understood put forth, was that he give some considered thought to whether or not this was possible. And drawing the analogy between President Kennedy's action in rolling back the steel prices.

Senator **Danforth**. You mean jawboning, in other words?

Mr. **O'Neil**. Pardon me?

Senator DANFORTH. Jawboning. It is called jawboning, is it not? In other words, the President would not have any legal authority. You do not contend, do you, that the President has some legal authority to roll prices back, or do you?

Mr. O'NEIL. Well, my contention is that it is worthy of thought to explore whether or not he does or does not. I do not think we can conclude it here.

Senator DANFORTH. But you are a lawyer. Mr. Strenio has said that right now there is not any legal power in the Federal Government to roll back prices. Do you think that there is?

Mr. O'NEIL. It seems to me that if President Kennedy could effectuate that goal, I would suggest that President Bush could do it as well. And if it takes jawboning or whatever we want to categorize it as being, there has to be some relief given to the consumers.

Senator DANFORTH. But that is what it is, is it not?

Mr. O'NEIL. It is leadership, sir.

Senator DANFORTH. Yes, but you are not saying that there is any legal authority. It would be a president just bringing some people into a room and saying, I really want you to reduce prices.

Mr. O'NEIL. Right. It is flexing that proverbial muscle that travels with that position, I think we agree.

Senator DANFORTH. But, no, there is not any muscle. It is just trying the power of persuasion, right? The oil companies could then say no.

Mr. O'NEIL. Well, I suppose that is a distinct possibility, Senator. But, as I say, the proposition that is put forth is to ask him to explore this.

Senator DANFORTH. I am sure he would be willing to explore it, but when you are thinking about fashioning a course of action, what you are really suggesting is that he bring some oil executives into the Oval Office and say, please, lower prices. But I do not have any legal authority to make you do it, I am just asking you to do it. Whereupon, they could say yes or they could say, well, Mr. President, in this country we are a country of laws, and we respectfully tell you that we are not going to do it.

And that would be one thing they could do, would it not?

Mr. O'NEIL. Well, that is very clear, Senator, they could. And understandably and thankfully we are a country of law. But beyond that is the fact that it seems to me that we have to visit that area, or that concept, I must say, to determine whether or not it is possible. And perhaps by simply examining the concept we might accomplish our goal.

Also, I am not in the position to know, being on the local level, what our strategic oil reserves are. For instance, if I were sitting in the position, perhaps I might think about releasing some of the strategic oil reserves that we have as a way of exercising some leverage, which would bring the price down. And it does not seem to me that they can have it both ways in the industry, saying we will not cooperation with you, Mr. President, and you, Mr. President, cannot release any of the strategic oil reserves.

I am not so learned as I know what those reserves are. I am here equally to learn as we all are. But that might be a bit of leverage that could be utilized.

Senator **Danforth**. It may be that once we release the oil reserves, of course we have shot that wad. They will not be available in the future.

Mr. **O'Neil**. I think, Senator, the last I understood, and I cannot say this conclusively, there were reserves for about 4½ months. And I would ask you to draw a comparison between the Nation having that reserve and a 70-year-old person who wants to travel or heat their home this winter. We really just cannot keep coming back and revisiting the issue of how we deal with the oil industry month to month time and time again.

Senator **Danforth**. But one thing it seems to me that we absolutely have to do is to become less dependent on oil in this country. We have created this vulnerability for ourselves. When we are in a situation when we are using more oil, not less, then we have not learned the lesson of the 1970's. When our oil consumption is bounced back up to the point where half of the oil in this country is being imported, we have created the vulnerability for ourselves.

And we have created, therefore, an inability to have the kind of flexibility needed to deal with problems. If we were not so dependent on oil, then a man like Saddam Hussein would not have such an easy job of putting his hands around our throats. If we were not so dependent on oil, then there would be competition beyond the oil industry itself for the oil industry.

I think there is an awful lot of blame to go around, and I think one thing this whole episode shows is that, in addition to complaining about the oil 'companies, and I am perfectly willing to pile on, but I think that we as a country must be less dependent on oil. We have not done a good job.

Mr. **O'Neil**. I do not disagree, Senator, and I can only recall—I believe it was 1971. I happened to live in Washington, DC at the time. We stood in line, where you parked your car the night before where you could purchase gasoline the next day. You remember that period perfectly well.

But we did not learn then, and I do not know—as we have created Federal energy offices, energy offices on the local level, home heating assistance programs, I wonder aloud, does that not just simply create another bureaucracy which ends up in an enhanced Federal-State governmental payroll? Does that really address the issue of educating citizens as to what the alternatives are?

I know personally I heated my home with wood for 2 years as a back-up supply of oil, a great stove that we had placed in the living room. But that gets old after a while, Senator, especially in New England, and there is nothing more convenient than turning that dial, and we are accustomed to that, so if we are going to have a Federal Office of Energy and other such departments on the local level, I think they have to be viable, and they have to deal with reality.

If I might carry on for a moment, I recently visited a small island off the coast of Rhode Island. It is known as Block Island. If you went there 10 years ago you would see a large propeller that was placed on the island to drive the power for the island. I believe the Federal Government put it into place.

Now it is not there any more. You wonder what became of it. I mean, much of this same initiative was here 20 years ago, and it went nowhere, so today we have to seek some relief for the consumer to drive the price down as easily as they so drive it up. That is my goal.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator BRYAN. Thank you very much, Senator Danforth. Senator Robb?

Senator ROBB. Thank you, Mr. Chairman.

I share some of the concerns that have already been expressed about the need for energy independence. I well remember the gas lines.

Some of the questions I have, I think would be better directed to one of the succeeding panels, because they relate to specifics of the pricing mechanism in the petroleum industry.

But I wonder if in the broader context, in the historical context, Senator Lieberman made reference to the intervention of President Kennedy in 1962, I think it was, with respect to the steel price increases and the job hunting that took place at that point.

Are there other examples where consumer prices have seemed to be out of sync with what would be regarded as legitimate market forces where considerations of Government intervention have been taken by Government agencies or others, to your knowledge?

Do you know what disposition was made of those requests for Government intervention or concern, other than the natural effect of simply highlighting the issue, as the Attorneys General have done and as these hearings? I understand there are three hearings on this topic alone here on Capitol Hill today, and that has sort of the effect of firing a warning shot across the bow of those who might want to go too far with some of the alleged abuses in this area.

But are there other instances where consumer prices have been the catalyst for an inquiry of this sort, to your knowledge, other than perhaps the steel crisis in 1962, and if so, what was the Government response in that context?

Mr. STRENIO. Senator, I do not have any recollections that come to mind. That is an excellent question. There may be some examples.

I know that on some of the enforcement matters that the Commission has undertaken in the past, at least in some instances there has appeared to be a favorable change in behavior upon commencement of the Commission process. Whether that is coincidental or not, one may judge case-by-case, but I cannot think of specific examples of the type that you are referring to.

I would hope, as you have indicated, that if there currently is illegal activity going on in the industry, that the attention that is being concentrated on the general issue will give pause to anyone engaged in or contemplating engaging in that type of activity, apart and aside from the fact that the Justice Department with its criminal authority apparently is looking at the matter, and the Federal Trade Commission has its staff monitoring the situation as well.

Senator ROBB. Let me just ask one other general question in that regard. What kind of criteria would the Commission establish for intervention?

Mr. STRENIO. In terms of legal intervention, sir?

Senator **Robb**. Yes. In other words, if there were going to be some specific intervention in the pricing mechanism or price structure, what kind of criteria would the Government establish for when is it appropriate, and what are the appropriate parameters of any constraints that might be placed on the market pricing system?

Mr. **Strenio**. If the predicate were to be a legal violation, I think that situation is fairly well spelled out in the law, in terms of the types of offenses that would constitute a violation.

Senator **Robb**. In the absence of allegations of illegality.

Mr. **Strenio**: In the absence of that, I do not think that there is currently a well spelled-out set of criteria. I think, as Senator Danforth mentioned earlier, the presumption is that you have market forces at work and that that is the way the economy generally proceeds.

If you do have some type of market failure, that is not an antitrust violation, I think that that is something that the executive branch agencies, in consultation with Congress, would need to discuss as to whether action is appropriate and, if so, what the parameters ought to be for that kind of action.

Senator **Robb**. Mr. Chairman, I think most of the other questions I have ought to be directed to a later panel.

Thank you.

Senator **Bryan**. Thank you very much, Senator Robb.

Senator Lieberman.

Senator **Lieberman**. Thank you, Mr. Chairman, and thank you again for inviting me to participate with the committee today.

General O'Neil, Mr. Strenio, your testimony has been very important and very helpful in this matter. The Attorney General has highlighted what is an important part of this problem, which is that it is very difficult for the States to deal with this problem alone.

I remember when I was involved in an attempt in 1985 and 1986 to seek some action from the oil industry. We actually filed a lawsuit that brought in lawyers from all around the country. We were delayed for years, and it was hard for one State to grab a hold of this monster and try to get some truth out of it, and that is why I think it is important now for there to be Federal action and leadership, and if I may, you were cross-examined pretty well by the former Attorney General of Missouri there for an idea that I offered earlier, so I feel I should just say a word about it and to my friend and colleague from Missouri.

I agree absolutely that the President has no specific legal authority to order a roll back in oil prices in this case, but he is the only person who has the moral authority to call in the American oil industry, and when I say the oil industry, I do not mean just the big oil companies, I mean the transporters, the wholesalers, the dealers, the leaders of all of those organizations, and appeal to their sense of national interest and their patriotism, if you will.

We are in a crisis now. We are not asking them to lose money, we are asking them just to be fair with us and not to take more from every consumer and from the American economy than they have been doing.

But he does not have the legal authority to do that, he has the moral authority. That is part of why I think it is time for us to think about giving the Presiderit some legal authority in these cases.

As Senator Kerry said so well, these crises occur over and over again. They happened in the 1970's, they happened after *Exxon Valdez* after the cold last December, and each time we go through the same process. It is a tough case, under the antitrust laws, to prove that the oil companies or anybody else got together in a room and entered into a conspiracy to inflate prices.

The awful truth is, they do not have to do that. They can just go right ahead and raise prices unfairly without a conspiracy, and we are all still suffering the same. That is why I want to focus for a minute, Mr. Strenio, on the authority that the Federal Trade Commission has in regard to unfair trade practices.

I would like to ask you, what is the definition of an unfair trade practice? I know you referred to evidence of market failure. Let me just cite to you that on Friday the Energy Department stated that there is no supply and demand reason for the recent gas and oil price increases. Is that not the beginning of a case that there has been a market failure here, and maybe—I think definitely—an unfair trade practice by the oil industry?

Mr. STRENIO. Senator, again, I need to be very cautious in terms of my response.

The statement to which you referred certainly is something that, at a minimum, warrants close attention and careful consideration as to whether that leads to some type of unfairness action. It would depend obviously on what the surrounding facts are.

You have asked about the criteria for an unfairness case. Three of the factors that the Commission looks toward in an unfairness setting are, first of all, is there serious consumer harm involved; second, is the activity something that consumers had no way of avoiding; and third, is the practice—whatever the practice is that is being complained of--something that has other benefits sufficient to outweigh the consumer harm, however that harm is quantified.

One can use that as a benchmark for analysis and start hypothesizing that maybe the facts here yield a result, maybe they do not, and I am not making any statement on that.

I do want to note in the interest of completeness that in terms of the overall system, in terms of the last criterion—whether the factors here are outweighed—I think it is very important that we make sure whatever we do with the market system, however we address it, that we are careful not to end up having a cure that is worse than the disease. That is something I am certain everyone is sensitive to given the historical experiences in this country.

Now if we uncover an antitrust violation, if there is a clear record of a violation here, speaking solely for myself, I think it is incumbent that it be pursued vigorously.

As to Section 5 in the absence of an antitrust violation, that has so many possible variables and so many factual permutations that I cannot begin to hazard a guess as to the right result.

Senator LIEBERMAN. I understand, and I appreciate your answer. It is actually a very helpful answer.

My own understanding of what you say suggests to me that the much more hopeful course for the FTC to take would be through the unfair trade practices section rather than through antitrust. The criteria you have cited are right on point. Regarding harm to the consumer, you could not have more harm not only to the consumer because we are not talking about just any commodity, any good or service. The fact is, for better or worse, as Senator Danforth correctly pointed out, America still runs on gasoline and oil. An unfair trade practice in the area of gasoline and oil runs through our economy.

The second problem is consume avoidance. We cannot avoid it. Gas and oil are not commodities where, if the price goes up, you can buy cheaper alternatives. Unfortunately, there just are no substitutes.

Let me ask one final question. What are the remedies? Could you order a rollback in prices? Speaking hypothetically, if you found an unfair trade practice, could you order a rollback or restitution to consumers?

Mr. STRENIO. Senator, you again raise an excellent question, and you touch upon an area of some controversy. I must stress that in this regard not only am I speaking solely for myself but my past pronouncements in this area have been a source of some controversy and less than universal agreement within the legal community.

In a nutshell, I am of the opinion as a general matter that the Commission has greater authorities to seek what I call disgorgement of ill-gotten gains for antitrust violations than has been the practice to date. I believe that there is statutory authority for this. I have written an article to that effect which I would be happy to share with you.

As to whether and how that might come into play in this situation, it is extremely hypothetical. I believe that to the extent, if any, that there would be sufficient agreement to pursue a case, it is more likely to be an antitrust law violation case than an unfairness case.

As to unfairness—and this is at the request of Congress in terms of what has been delegated to the Commission—because we have such broad authority in the area of unfairness we, have been directed in general that were we to find for the first time that a practice is unfair, the proper course is in general to get a cease and desist order to stop the practice in the future. If it happens again, the Commission then can obtain civil penalties. Because in some sense in an unfairness finding we are treading on new ground, the notion is that it would be too much for us to simultaneously retroactively impose a substantial financial penalty if we are pursuing that unfairness authority.

So it is a very complex and mixed set of circumstances, Senator, that I think is very hard to read as to a bottom line right now.

Senator LIEBERMAN. Thank you. My time is up. You will not be surprised to hear that this lawyer agrees with your interpretation on the part of the FTC to order disgorgement.

Senator Robb wanted to know whether we were suggesting that we all save our gas receipts. I hope we can.

Thank you, Mr. Chairman.

Senator BRYAN. Thank you very much, Senator Lieberman.

Let me now yield to Senator Pressler, a Member of this committee who has joined us, for any opening statement he might wish to make in addition to any questions he cares to ask the panel.

OPENING STATEMENT BY SENATOR PRESSLER

Senator **Pressler**. Mr. Chairman, I do have an opening statement.

I want to thank you for holding this hearing in such a timely fashion. This is a very important and pressing issue to us all. In my State, gas prices have gone up in double digits in the last few days. In addition, bulk oil has gone up even more. People are concluding that our great oil companies are gouging the public as a result of this situation in the Middle East. There is a great frustration.

I joined my colleagues in the letter initiated by Senator Lieberman urging President Bush to convene an emergency oil price task force. As with all the past experiences when there has been a cold snap in the winter with propane prices going up dramatically, there is a conclusion that the oil companies do gouge the public, and there is a strong feeling in our country that Washington is not tough enough in acting on this.

Perhaps this hearing will yield a need for new legislation, but that will not solve the immediate problem. People are saying, what are you doing about it? What can we do? Now it is true, as we have heard here today, that the Federal Trade Commission is monitoring the situation. Also, the State Attorneys General are trying to help. We have the Department of Justice enforcing the antitrust laws. It seems that nothing is happening, except prices are going up.

I guess my question to each of you in addition to that which you have already said is, what can be done immediately to stop the increase in gas prices? Is there some action that the Federal Government can take, even if the President appointed this task force? Is the Government of the United States helpless in the face of this situation?

Mr. **Strenio**. Senator, to my knowledge there is no statute on the books that would empower the President to order an immediate change in prices to a lower level. I believe that in terms of any incentive for oil companies to engage in illegal activity, if they were not on notice before this hearing they certainly must be now that there is the hot glare of publicity and that if there is illegal activity, it will be found out and there will be heavy sanctions for that type of activity.

Beyond that, if what is going on is not illegal and not price gouging but a simple market response to events in the Middle East—and as I have said, I cannot reach a conclusion on the basis of the very preliminary information that I have—then there is no action to be taken.

If I might just make one very brief point, which is that it is very difficult for us in antitrust enforcement to reach a conclusion based merely upon either prices going up or prices going down. The fact that prices are going up does not in itself mean that there is a legal or market problem. Sometimes that is just the way the market naturally works.

On the other hand, sometimes prices go down, and that may still mean that we have problems with collusion or other impermissible, illegal activity. For example, we have seen prices go down during periods under the OPEC collusive structure, and no one would say that we did not have a problem in some sense even though prices were going down. So that point is simply meant to illustrate why looking at price direction is relevant information and information that certainly deserves attention, but in and of itself, it is not possible to make a firm conclusion on that basis alone.

Mr. O'NEIL. Senator, I wish I did have that answer. I think none of us have that answer. That is essentially why we are here, to form a partnership which will enable us to do so.

Senator PRESSLER. Yes. Indeed, I guess none of us do. I am going to hold several meetings in August, and the average citizen on the street is going to say, why did someone not do something about it? Obviously the shortage of oil has not yet occurred, and prices have gone up substantially. There must be somebody who can do something about it in the Federal Government. It seems as though our answer is merely that if there is anything illegal going on we will find out about it later. In the meantime we have to sort of ride along.

Perhaps we need new legislation on something so critical as oil prices that continue to be abused. I know last winter in my State, the propane prices went up dramatically during a cold snap, and there was really no shortage of propane. I asked the GAO to do a study, and they are presently doing that.

There is a very substantial abuse of power by oil companies and those who control this. Although I am a free marketeer usually, and as much as I hate price controls, we have reached a point where maybe we need some tough new legislation regarding oil prices.

Who can act on this problem this week in Washington, DC?

Mr. O'NEIL. Senator, if I could just share a thought. I do not know how worthy this is, but I think we have to look at this in sort of a twofold sense.

We came before the Congress last winter and the Congress urged us to join with them in remedying the escalating prices. Now we are back again this summer. I wonder if anything really came out of that, as all of you do, but we do not know, or at least, I do not know, whether when the price is down at $16.50 a barrel, whether the refineries are producing to the max. I think we should determine that. That will not solve today's problem, but it will at least give us an idea with respect to the integrity quotient of the industry.

For today, I think as Senator Danforth was suggesting—and I appreciate you pressing me, Senator, with respect of what do we urge our Chief Executive of the Nation to do that is realistic? I think that is the way we have to deal with any situation.

If you look at the market today, the Stock Market today, I think probably if you had oil stock you would probably see it bounced up, I think. I really have not read the quotes of the morning, but I think you would probably find that true, so somebody is making money out there. So we want to keep the free enterprise system working, but at this time we are in a crunch and we need to have the industry gain some sort of social consciousness.

Senator **Pressler**. Are the antitrust laws adequate for you, as an Attorney General—a State Attorney General? Of course, I know you are operating on a State basis, and I know we cannot expect the States to handle a problem that is national and international in scope, but maybe we need a new antitrust law regarding just energy prices.

Mr. **O'Neil**. It might be, Senator. I do not pretend to be that intimately knowledgeable of every facet of the antitrust laws, that is for sure. You know, it is a litigious endeavor. We can initiate litigation, and I think as the gentleman from the FTC points out, it is way down the line, and that is your concern as well, if you are even going to be successful.

Senator **Pressler**. In conclusion, let me say that I guess it is passing strange that we sit here in this committee room, all of us in agreement as to the crisis we are in, and the fact that oil prices are being raised and the public is being gouged without, really, a shortage, and there is not really any one part of Government that can do anything about it.

We can continue to hold hearings and talk about it and convene task forces and so forth, but I think the time has arrived when the energy companies of America should be put on notice that we need some new legislation in this area, not only for this situation, but for the propane situation last winter and elsewhere.

Senator **Bryan**. Thank you very much, Senator Pressler.

We do appreciate you being here this morning, both of you, on such short notice. Thank you very much.

Mr. **Strenio**. Thank you, sir.

Mr. **O'Neil**. Thank you.

Senator **Kerry**. Mr. Chairman, I just want to inquire, it is my understanding that the representatives of the oil industry who we are obviously waiting to question are at the House now and we will be having them come over when they are finished there, is that correct?

Senator **Bryan**. That is correct. The Department of Energy is also shuttling back and forth. I might just indicate that we are going to take the Department of Energy out of order, because there are two other hearings in the House that they have been requested to attend, so we will get to them as soon as we can.

Senator **Kerry**. I appreciate that.

Senator **Bryan**. Our next panel will consist of Mr. Edwin S. Rothschild, the energy policy director of Citizen Action, Mr. William McGilacuddy, president of the Virginia Service Station Dealers and Auto Repair Association, who will testify on behalf of the Service Station Dealers of America, and Ms. Lana Batts, senior vice president, governmental affairs, of the American Trucking Association.

Ladies and gentlemen, we welcome you to the subcommittee hearing this morning. We will begin, Mr. Rothschild, with you.

STATEMENT OF EDWIN S. ROTHSCHILD, ENERGY POLICY DIRECTOR, CITIZEN ACTION

Mr. ROTHSCHILD. Thank you, Mr. Chairman. We very much applaud your holding these hearings at this time. Clearly, there is a need for the American people to hear and find out what is going on.

I do want to say something about the deja vu. I think one of our ex-presidents said, here we go again. We are going again. This has been going again for years and years and years, when oil companies have seized opportunities of perturbations in the marketplace with no real physical shortage, but panic in the spot markets in the futures market, seizing on those prices and passing them through to consumers.

What is remarkable is that in 1990 it is happening so very fast. It is a function of the changes that have taken place, but certainly it has not changed oil company behavior. I do not expect oil companies to behave any differently, and we should not be surprised at their kind of behavior. They have done it before, they will do it again.

We had the FTC here, we had the Justice Department. I have got testimony from recent years on heating oil prices and gasoline prices. The Justice Department does not do anything. The FTC does not do anything. They study it, they look at it, and what do they conclude? The market at work.

These agencies have had a philosophy over the last 10 years, Chicago School economics, that says, basically, if the market is there it will function appropriately up and down, and there is not going to be anything that they will do.

The FTC, the Justice Department, have allowed mergers and acquisitions of enormous proportion to occur over the last 10 years. Gulf is gone, Getty is gone. Refineries have been closed across the country. We have had a restructuring of the petroleum industry in this country that has left a handful of major oil companies controlling large segments of the market.

The American Petroleum Institute will point out well, we have lots of companies and no one company has more than 8 percent of the national market. Well, oil companies do not operate on a national market, they operate on regional and metropolitan markets. The concentration ratio is very high in most metropolitan markets.

I think you have to understand what happens. Let us take a look at this year, and there are some charts in my testimony that bear this out. Between January and July of this year, crude oil prices fell an average of $5 a barrel. Gasoline prices went up.

Consumers, who we are told by the industry gained the benefits of lower prices, did not gain the benefits of lower prices when crude oil prices fell, and that is because refineries in May and June cut production, reduced inventories of gasoline. In other words, they helped keep supply at a minimum level.

Refining operations, refining capacity now are tight. The companies have the American public in a strangle hold, and any time there is any kind of explosion, accident, disaster, and they see the spot market go up in response because it is very volatile, we get these kinds of increases.

So what is to be done? I am not going to rely, and I would not want to rely, on antitrust enforcement or the FTC or the Justice Department. It will take years. In fact, States Attorneys General, and I think the former Attorney General from Connecticut, Senator Lieberman, knows very well that in 1973 a number of States sued the major oil companies. I think they are still in court. Consumers need immediate relief. The economy needs immediate relief.

I was glad to hear Senator Bryan and other Senators talking about jawboning. I think that is critical. If the President of the United States uses the power of his office to bring these companies in and say, you have to act in the national interest, do so, it could have some effect, and certainly using the SPR in a coordinated fashion with the European and Japanese allies, who also have strategic petroleum reserves, is precisely the thing to do.

What you have to do is dampen the speculative fervor that exists by people uncertain about the future, figuring that oil tomorrow is worth more than oil today, and bidding up the price.

I want to make a footnote here. Oil companies participate in the futures and spot markets. We do not know whether they are buying or selling. We need a full-blown investigation by the CFTC, the Commodities Futures Trading Commission, to find out who is participating and who is helping boost those futures prices that get rolled into prices at the pump.

So we need that type of immediate action, but I think we also need to focus on the longer term, because we are in this situation because of the failure of the past administration's energy, or lack of energy policy.

I applaud you, Mr. Chairman, for your bill on automobile fuel efficiency standards. I am glad that the Senate Energy Committee passes it, and I do hope that the majority leader keeps his word and we get a vote on the Senate floor. We need to pass that.

We need to get fuel economy standards improved so that we can use less oil. We need to shift to alternate fuels. We have the clean air amendments right now in conference committee, where both House and Senate passed provisions that would increase the use of alternate fuels like ethanol and ethers.

This is very, very critical. These are domestically based fuels. They are cleaner environmentally and we have some control over their supply, and it will provide some competition to the oil industry. This is why the major oil companies opposed methanol, they opposed ethanol. They just want to reformulate their gasoline with refining crude oil.

So we think that we have to take two kinds of approaches here, a short-term approach and a long-term approach.

Let me just say that what has happened with the increase in crude oil to $28 a barrel, overnight, the oil industries, just their crude oil inventories in the United States of roughly 300 million barrels, let us say, are worth now an increased $3 billion. That is a windfall on inventory profits. We are looking here at a massive windfall on inventory profits.

I think we have to deal with that and deal with it directly. We should not wait for antitrust. We should have, I think, the Congress needs to have a full-blown investigation of its own, using subpoena power in the appropriate committees to get the evidence.

I would not rely on the Department of Energy. I would not rely on the FTC and Justice Departments to do that work. You need to do the work here, and the work has to be done in the House.

Thank you very much.

[The statement follows:]

STATEMENT OF EDWIN ROTHSCHILD, ENERGY POLICY DIRECTOR, CITIZEN ACTION

Mr. Chairman and members of the Committee. My name is Edwin S. Rothschild, and I am the Energy Policy Director of Citizen Action, a nationwide consumer organization with over two million members. As you can well imagine we are deeply concerned about the rapid rise in gasoline prices following Iraq's invasion of Kuwait. We applaud your decision to hold these hearings to determine the nature and extent of petroleum product price increases and whether they are justified by current economic and political conditions.

A former President liked to use the expression, "Well, here we go again." One might say the very same thing about what is happening in the oil market. A perceived threat to oil supplies followed by panic among oil buyers followed by a rapid rise in spot or futures market prices followed by rapid increases at the gasoline pump. In 1973-74 during the so-called "Arab Oil Embargo," again in 1978-79 during the Iranian Revolution, violent events in the Middle East spurred price speculation, supply hoarding and sharp increases in gasoline, heating oil and other petroleum product prices.

In the United States, we saw a small scale version of this scenario last Spring following the crash of the *Exxon Valdez*. In none of these events was there an actual physical shortage of supply, but the expectation or the perception of shortage by oil traders, speculators and oil companies led to shortages and price hikes.

Iraq's August 2 invasion of Kuwait has triggered petroleum price increases that appeared overnight on the pumps of gasoline stations across the country. Oil company executives say that normally crude oil price increases take four to six weeks to show up at the pump. So, what happened? How come consumers at the retail level are paying for crude oil that has not yet been delivered into oil refiner storage tanks?

Industry executives also claim that they are simply responding to the market, that they are not setting prices, and that the price changes reflect current market conditions, the interplay of supply and demand. We are also told that oil today is a commodity and that its price is determined by the futures market, a supposedly accurate forecaster of future prices. While some of these explanations have some truth, a large part of the story is left out.

Market Structure and Gasoline Supply Constraint

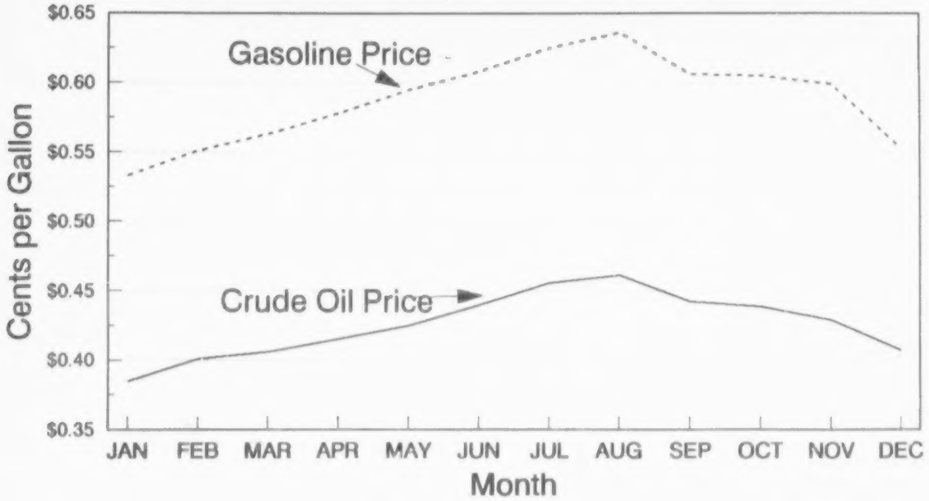
In order to appreciate how oil prices are determined, we need to understand what has happened to the U.S. oil market over the last 10 years. There has been a great wave of consolidation. Many large, medium-sized and small companies have disappeared through mergers, acquisitions, or other restructuring arrangements. These consolidations, like Chevron's acquisition of Gulf or Texaco's purchase of Getty, have left fewer competitors in the marketplace.

It is also important to understand that gasoline, heating oil and jet fuel are not sold in a national market. Thus, it is meaningless to talk about oil company market concentration figures on a national basis. But, even on a national basis, the largest four and eight companies have increased their control over refining and marketing of products. On a regional or metropolitan level, concentration ratios are even higher.

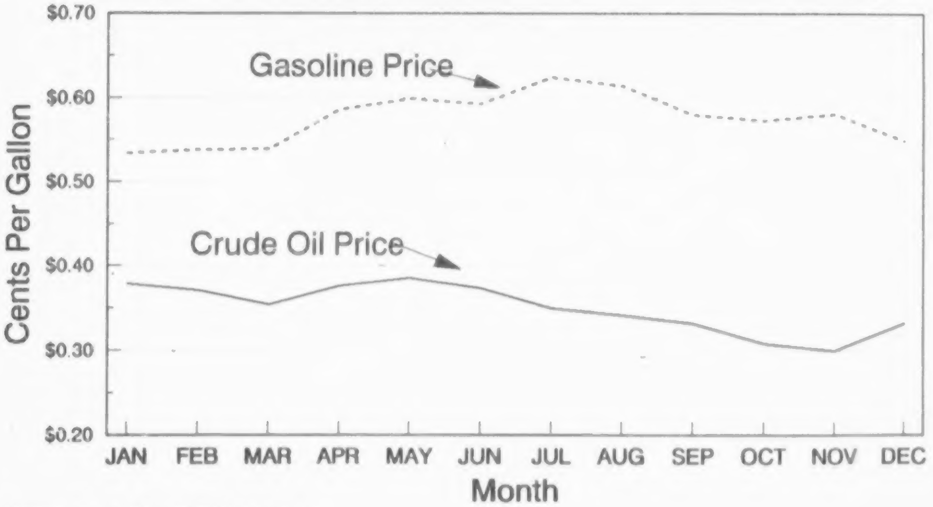
Less competition is only one element of current conditions in the U.S. refining market. As a result of restructuring, there is little excess refinery capacity available to produce gasoline, the most profitable product to the refining industry. This has enabled the major oil companies to keep the price of gasoline high, even when crude oil prices fall. This is exactly what happened during the first seven months of this year. As the following graph demonstrates, despite the substantial $5 per barrel decrease in crude oil prices, gasoline prices increased. Consumers did not get the benefit of falling crude prices. The lag effect did not occur. Similar graphs for 1987, 1988 and 1989 show what happens in a normal year like 1987 and the two subsequent years, when companies took advantage of falling crude prices in 1988 and the *Exxon Valdez* in 1989. The final graph compares refiner margins (the difference between crude oil and the wholesale price of gasoline) for the five years. It is clear that margins in 1990 were even higher than they were following the rapid gasoline price hikes in 1989.

What did occur was a decline in gasoline production in May and June that left inventories at the end of July 10 million barrels below end of July 1989 levels. Refiners have had plenty of crude oil to refine. In fact, crude oil inventories are at an eight year high. The companies claim that demand for gasoline has increased. This is untrue. According to the Energy Information Administration, gasoline demand for the first seven months of 1990 is running behind demand during the same period last year. In short, at least on a preliminary basis we can conclude that gasoline prices increased during this period because oil companies were constraining supplies.

Refiner Acquisition Cost of Crude Oil
and Wholesale Gasoline Price - 1987



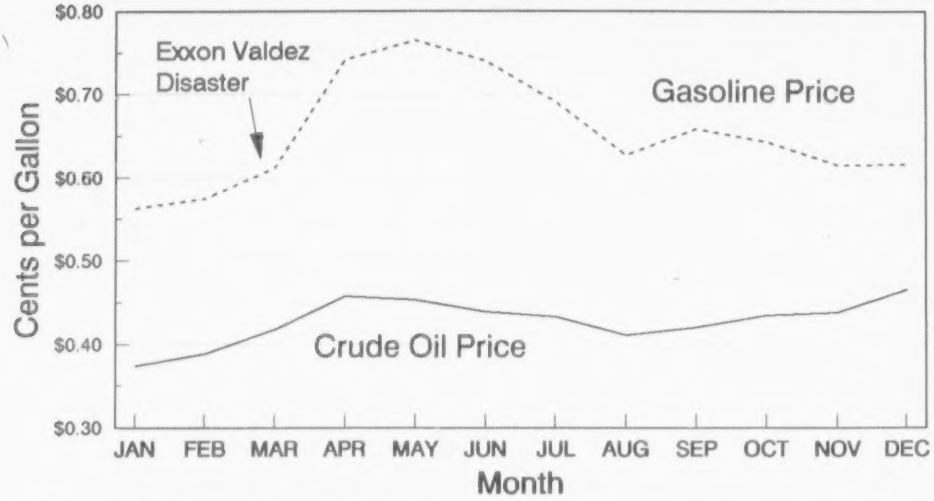
Refinery Acquisition Price of Crude Oil
and Wholesale Gasoline Price - 1988



Source: Energy Information Administration.

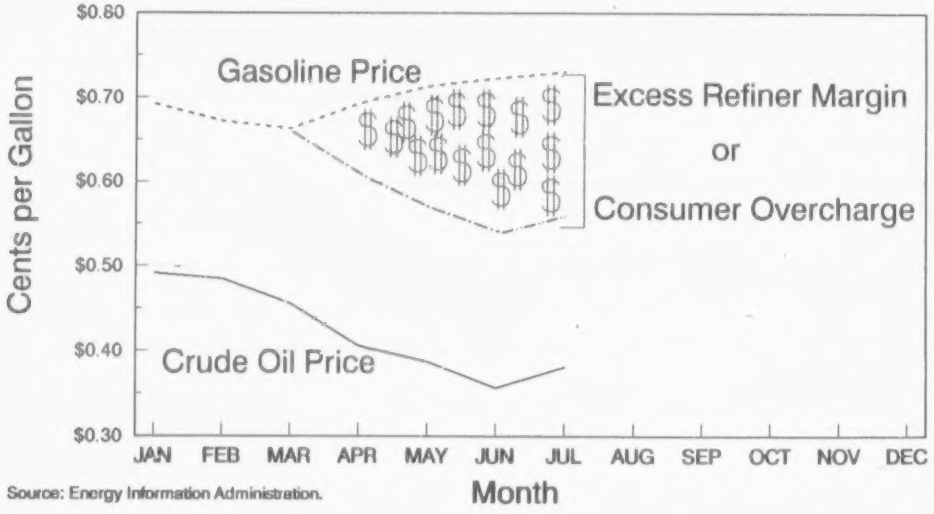
Refiner Acquisition Cost of Crude Oil

And Wholesale Gasoline Price- 1989



Refinery Acquisition Cost of Crude Oil

and Wholesale Gasoiine Price - 1990 (7 Mos.)



Source: Energy Information Administration.

Gasoline Prices Following Iraq's Invasion of Kuwait

We have all heard that crude oil and gasoline prices have increased substantially since August 2 when Iraq invaded Kuwait. It is our contention that major oil companies have responded to this grave international event by committing economic aggression. What Saddam Hussein did with guns, the major oil companies are doing with gasoline pumps. This behavior, however, is not surprising nor is it illogical. Most major oil companies are multi-national corporations. These companies are interested in maximizing their profits. When fear, panic and hysteria grip the oil markets, major international companies seize every opportunity. They help drive up prices in the spot and futures market, because they participate in those markets. If they start buying and bidding up the price, they are in reality increasing the value of their lower cost inventories. Crude oil that these companies purchased a few short months ago for $15 or $18 a barrel is today worth $28 a barrel. Overnight the 300 million barrels of major oil company crude stocks can now be sold for roughly $3 billion more than it cost to purchase. But that's just crude oil. The same can be said for gasoline, diesel fuel and the other products that were refined from lower cost crude. In other words, oil company decisions to follow the market, which they have helped create and drive, have resulted in a tremendous inventory profits.

The tables below show the most recent pricing data available for gasoline. We can see that spot market prices have risen swiftly.

August Spot Market Price Changes
Cents/Gallon

Date	8/1	8/2	8/3	Change
WTI	51.0	54.0	62.0	11.0
US Gulf Premium	71.1	73.8	84.2	13.1
New York Premium	72.7	75.2	84.7	12.0

Source: The Oil Daily.

Taking their cue from these markets, major companies posted increases ranging from 2¢ to 7¢ in East Coast and Midwest markets.

Major Rack Prices - Premium
East Coast - Cents/Gallon

Company	**7/27**	**8/3**	**Change**
Amoco	81.7	83.6	1.9
BP/America	79.6	85.1	5.6
Chevron	77.6	84.3	6.7
Exxon	80.0	84.0	4.0
Mobil	82.8	87.8	5.0
Shell	81.9	86.3	4.4
Texaco	82.0	85.0	3.0
Midwest			
Amoco			
BP/America	78.1	81.6	3.5
Chevron	75.8	81.9	6.1
Exxon	77.7	81.6	3.9
Mobil	77.3	82.7	5.3
Shell	80.3	85.5	5.2
Texaco	73.3	80.4	7.1

Source: The Oil Daily.

It is these prices that were immediately passed on to retail dealers, who have in turn passed them on to consumers. Based on previous work we have done, we do not believe that the higher prices posted on retail pumps are the fault of dealers. While there may be some instances where retail service station dealers are taking advantage of consumers, in general, the price increases are coming from refiners.

We believe that these price increases are unjustified. But, major oil companies are businesses and, and businesses will seek every profit opportunity available. The deadly combination of panic trading, price speculation, and ineffective competition has allowed these companies to charge what the market will bear.

Short-term and Long-term Solutions

Certainly, the events unfolding in the Persian Gulf will continue to affect the price of oil. As the probability of oil embargoes and blockades of Iraqi and Kuwaiti oil grows and possibility of military action increases, oil prices will increase even further. We have already hit $28 a barrel. If tensions continue to grow, the price of oil will go to $35 or $40 or $45 a barrel. Despite the high levels of inventories in the United States and the rest of the world, a crisis mentality has gripped the oil market.

There is a need for action to counteract these forces. Rapidly escalating oil prices will devastate our already weak economy. Rapidly escalating oil prices will be passed through to consumers in higher prices for energy, food, transportation, housing and other necessities. We believe that several things must be done. President Bush must call to the White House the chief executives of all the major oil companies and tell them that it is not in the national interest to raise petroleum prices in anticipation of higher costs. Just as President Kennedy called on steel companies to roll back prices, we believe that the President must call for price restraint. We are calling on consumers to boycott the most expensive gasoline stations and buy from the lowest priced suppliers. We are reminding consumers that gasoline is the same whether it is bought from a brand-name station, like Texaco, or a non-name brand station. We are urging citizens to pay in cash -- in pennies for the high priced stations -- rather than credit cards.

While these are important actions that people can take, the greatest short-term impact on price will come from President Bush's order to start selling oil from the 600 million barrel Strategic Petroleum Reserve. This supply of oil was designed precisely for the current situation. Together with Japan and Europe, which have their own strategic supplies, the United States can sell oil into the market and thereby pour water on the flames of price speculation. But the President needs to act quickly, in view of the fact that it will take several weeks before any oil starts to flow.

There are those who believe that the Justice Department and/or the Federal Trade Commission should investigate gasoline pricing. We do not have much confidence in these agencies, because of past performance. Even if these agencies decided to investigate, there would be no immediate relief for consumers. By their very nature antitrust actions take a very long time.

In addition to short-term actions to force a reduction in oil prices, we must begin to address our longer-term problems. This means creating a national energy policy that shifts our emphasis to energy efficiency and renewable fuels. Congress has before it several pieces of legislation that could greatly reduce our exposure to the consequences of oil disruptions. We urge support of Senator Bryan's bill raising auto fuel economy standards. Similarly, we believe Congress has an opportunity to reduce our reliance on oil by supporting provisions in the pending Clean Air legislation that promotes the use of alternative fuels like ethanol.

Senator **Bryan**. Thank you very much.

Mr. McGilacuddy.

STATEMENT OF WILLIAM McGILACUDDY, PRESIDENT, VIRGINIA SERVICE STATION DEALERS AND AUTO REPAIR ASSOCIATION, ON BEHALF OF SERVICE STATION DEALERS OF AMERICA; ACCOMPANIED BY JIM DASKALL, GENERAL COUNSEL

Mr. **McGilacuddy**. Thank you very much, Mr. Chairman. I am Bill McGilacuddy. I am a service station dealer from Fairfax County in Virginia. I am here representing the Virginia Service Station Dealers, and also speaking on behalf of the 60,000——

Senator **Kerry**. Could you pull the mike a little closer, please?

Mr. **McGilacuddy**. Speaking on behalf of the 60,000 angry members of the Service Station Dealers of America. Our members are angry, Mr. Chairman and Senators, in the same way that the consumer is, and the way that you are, of rising prices, which we have absolutely no control over, either. We take the heat from the motorists right out there on the street, as we should I suppose, except that I am not sure that the motorist is aware that the service station dealer has absolutely no control over those prices.

When you have a situation of the service station dealer being a captive member to his refiner on the prices, with no control of where he buys his product, but just to take those increases, then, when they rise overnight five or seven or eight, or in some case, 10 cents a gallon, the service station dealer has no choice but to pass those costs on to the street, then take the heat as if we have control over those.

Just last year, we have heard earlier today, and it was obvious with the unfortunate Valdez incident, gasoline prices then went up dramatically. I am as confused as you and the consumers as to why a disaster of that magnitude to one refiner would automatically increase the wholesale cost to all refiners and all across the country.

We heard in 1986 that when crude prices feel that we would need 45 or 60 days before those prices would find their way into the wholesale market, to dealers and ultimately to consumers. Well, here we go last week, an incident that automatically increases the prices again on future expectations. The bottom line is that the dealers and the consumers were overcharged and appear to be overcharged again with absolutely nothing that they can do about it.

The suppliers and refiners now are singing a different tune of wholesale expectations and replacing diminishing product at a future price. Well, that just does not seem right to me. And particularly in the case of the drop in prices not reaching the wholesale level for the dealers. When there is a drop in the wholesale price from crude or to the independent wholesale dealers, that usually comes two cents or three cents, and is immediate from the refiner. Not so to the service station dealer.

The end result for the service station dealer may go on for weeks, and in some cases months, before that drop in the wholesale price is passed along to the service station dealer. That is indicative of one of the very serious problems that our members feel should be addressed and that existing law does not address, and that is, there is absolutely no competition on the wholesale level, I repeat, no competition.

Service station dealers across this country are tied to their refiner to buy the product from that refiner at the price that that refiner sets. And they are prohibited by their lease arrangements from going out and purchasing it anywhere else even though many times that product is available at a lower cost. That absolutely restricts any competition on the wholesale level, and in fact, there is no competition.

Refiners have stated before, and I am sure will tell you today, that there is very intense competition in the motor fuel industry. The intense competition is at the retail level, with 60,000 service stations competing out on the street by supply and demand. And if a price goes up, the consumer has a choice to go to another station. The independent dealers do not have.that choice. They have to take the price as it is presented to them today. If the price goes up, that is it, there is no choice.

The situation that I would share with you that my State of Virginia is looking at as possible solution to the problems that we perceive in this anti-competitive situation with the refiners is legislation initiatives that would require the refiners to allow the independent dealers to purchase the product wherever they can find, and not be restricted by these lease arrangements to only purchasing from that refiner at a price set by the refiner.

It is apparent to all of us that the existing laws do not cover the situation that we have now, and we would ask that you look into further remedies.

I will be happy to answer any questions that I can. Mr. Daskall, General Counsel of the Service Station Dealers of America is here with me.

Senator **Bryan**. Thank you very much, Mr. McGilacuddy.

Ms. Batts, it is a pleasure to have you with us this morning.

STATEMENT OF LANA BATTS, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, AMERICAN TRUCKING ASSOCIATION

Ms. **Batts**. Thank you.

Mr. Chairman, again, I would like to reiterate what has been said earlier today and thank you for the opportunity to talk. I too commend you for the timeliness of these hearings. At 7:30 last night, though, I was questioning the timeliness. I also want to personally thank you for the help that you have given our industry by introducing your bill to spend down the Highway Trust Fund money. It is an item that needed attention and we appreciate your action.

I am here representing the American Trucking Association's 4,000 members, and the 30,000 members that we have throughout the States representing our state associations. We represent every type and size of fleet. But to give you some perspective, my members haul 90 percent of all the revenue surface transportation freight in this country today. And we are 5 percent of the gross national product.

You have heard the saying that armies travel on their stomachs. Well, the trucking industry is next to useless if it does not have any fuel. It also is next to useless if the fuel is out there and we cannot afford to buy it.

Certainly, what we have seen over the last week has already had a devastating impact on the trucking industry, as we have seen these fuel prices escalate far beyond any reasonable expectations. I do not believe that there is any Government action that can be taken today to overcome the irreparable harm we have witnessed in the last week. But I think there is some prompt action that you can take today which will stop the irreparable harm that is happening to the trucking industry specifically.

In my written testimony I have included some charts and graphs which depict what is happening to the industry. Suffice it to say, that from July 16th, when we saw the lowest fuel prices since the crisis back in January, to August 6th, fuel prices have gone up 13 cents a gallon on average. Now, unfortunately, I have to apologize for being originally a statistician, and one of the laws of statistics is that a statistician can drown in averages. The average is 13 cents. But some truckers have seen 20-cent increases in one week.

To give you some sense of what that means, the average consumer could be buying 10 gallons a week. But for a trucking company or a single truck, it will average 400 gallons in one week; you can now understand what a price increase of 10 cents or 20 cents a gallon will do when one buys 400 gallons a week.

From the price increase we have seen from July 16th to today has increased the cost of fuel on our revenues from 8.5 percent of our revenues to 9.6 percent of revenues. That is a 1.1 percent increase. That is our profits. We just wiped out the profits for an entire industry that moves 90 percent of all of the surface freight, and is 5 percent of the gross national product.

What we were hearing yesterday is that some dealers are now restricting the product that they will sell to us. As of yesterday I had a price problem. I do not know when I get back to my office if I also have a supply problem.

But, clearly, if I have a supply problem, the price problem is going to be magnified.

So what can government do?

We firmly believe that to institute the kinds of controls we saw in the 1970's is absolutely counterproductive. We are still trying to get away from what that did in terms of less domestic production and less refining capacity. On the other hand, price gouging should not be allowed to continue:

What we have in my industry is an interesting phenomenon. Deregulation basically says you sell at one price and the buyers respond. But in the trucking industry today, under the current regulations at the ICC, we cannot raise our rates until seven working days. On Friday, some truckers went to the ICC to put in price increases that cannot take effect until next Thursday.

On Friday we asked the ICC to allow truckers raise their rates on one day's notice. It was similar to the petition we filed with the ICC last January, in which they allowed truckers to raise their rates on three working days' notice, which means Monday, Tuesday, Wednesday, Thursday, Friday. Unfortunately, as we saw this weekend, fuel prices are going to increase on calendar days, including weekends.

We would like to have a one-day working day notice.

This committee sits in a unique position to help us. I do not think the Government can do much to help the industry solve the problems in the short run, but you can take a position today which will solve our irreparable harm, and that is to urge the ICC to accept our petition which would allow us to increase those rates on one day's notice.

Finally, I think as everyone listens to what is happening we begin to understand the serious implications of the last week's events. The one thing it is going to do is force us to go back to the drawing board and evaluate the assumptions that we have made over the last 15 years regarding oil. For government, that means going back and looking at all of those decisions, as well as non-decisions, that were made concerning domestic energy production, the strategic petroleum reserve, and even the Synthetic Fuels Corporation.

For industry, we have to do the same thing. We have to go back and ask ourselves are we using our petroleum supplies wisely. Are we using them most productively? For the trucking industry, that means moving more freight with the same gallon of fuel.

About a month ago the Transportation Research Board issued a report which said if you allow trucks to run at higher gross weights you could save not only the consumer billions of dollars, but also there would be no adverse impact on pavements, there would be no adverse impact on safety, and we would save fuel. As we are evaluating all of our basic assumptions concerning the energy industry, I would urge this committee also to evaluate our assumptions concerning the use of more productive truck trailers.

Thank you very much.

[The statement follows:]

STATEMENT OF LANA BATTS, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, AMERICAN TRUCKING ASSOCIATIONS, INC.

My name is Lana R. Batts. I am the Senior Vice President of Government Affairs for the American Trucking Associations (ATA). ATA is the trucking industry's national trade association, comprising over 4,000 motor carriers and suppliers, 51 state associations and 10 conferences representing different industry segments. Our federation totals over 30,000 trucking-related businesses of every size and type, ranging from single-truck owner-operators to fleets of 100,000 vehicles.

Every one of those companies has been affected by the extreme run-up in diesel fuel prices that has cccurred in the past week. For many businesses, particularly for individual owner-operators, the increase is becoming devastating.

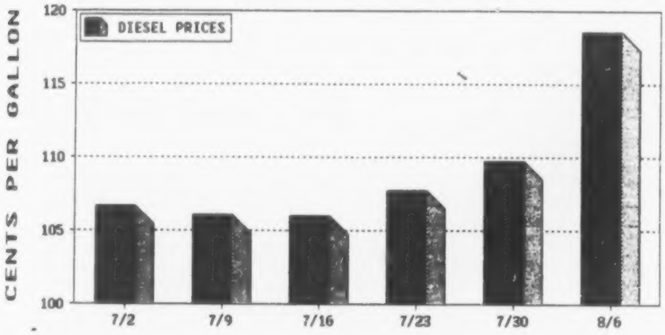
No government action can undo the harm that has already occurred. But prompt action on allowing truck owners to pass along their costs, and vigilance regarding petroleum product prices, can help keep the current situation from having the same disastrous effect as last winter's fuel price crisis on the trucking industry.

The remainder of this testimony discusses the magnitude of the increases that have occurred, the potential impact on various segments of the trucking industry, the need for timely approval of tariff changes, the importance of close scrutiny of petroleum prices, and long-run measures.

Magnitude of Increases

Figure 1 provides a graphic overview of how sudden and how large this increase has been on a national average basis. As the chart shows, fuel prices (at truck stops surveyed weekly by the Interstate Commerce Commission) have increased dramaticly over the past month. The average price rose to $1.18.6 on August 6th, almost a 13 cent increase since July 16th.

DIESEL FUEL PRICES
July 2, 1990 - August 6, 1990



I.C.C. Survey of Truckstops

But as the statistician who drowned in a stream that averaged two feet deep, an average can often understate the depth of a problem. ATA has received reports in the last week of bulk diesel fuel increases of as much as 20 cents a gallon from July 2nd to August 5th. Fuel costs have escalated to their highest August price in 5 years and are continuing to rise.

For car owners who buy 10 gallons once a week, such an increase is little more than an annoyance. But for an owner-operator who buys 400 gallons a week or a 100-truck fleet that needs 40,000 gallons weekly, these prices are catastrophic.

operator who buys 400 gallons a week or a 100-truck fleet that needs 40,000 gallons weekly, these prices are catastrophic.

In 1988, when fuel prices averaged $1.05 per gallon, ICC-authorized carriers spent 8.5% of revenues on fuel. At the August 6, 1990 fuel price of $1.18, fuel costs would have consumed 9.6% of revenues. According to 1989 quarterly reports filed with the ICC, general freight carriers earned profits of only 1.75% of revenues. The fuel increase of 1.1 percentage points would wipe out almost the entire industry profit. If fuel prices continue to increase at the rates experienced over the past week, sometimes as much as 10 cents in a single day, many carriers will not be able to continue to operate without some relief.

Impact by Industry Segment

All segments of the trucking industry are vulnerable. For truckload carriers and individual owner-operators, fuel costs are a substantial proportion of total costs. In the less-than-truckload (LTL) business, over-the-road and pickup-and-delivery operations are quite fuel-intensive, but the overall business also includes significant cargo-handling, terminal and administrative costs. Data for 1988 showed fuel costs to represent 13% of revenues for truckload carriers, 11% for specialized truckload carriers, and 5.5% for LTL general freight carriers as calculated from ICC reports. Comparable reports do not exist for owner-operators, but fuel costs could represent as

The increases are especially worrisome for truckload carriers, which operate on a thinner margin in general to begin with. Although comparisons are not yet available for 1989, the ICC reports for 1988 show that the average profit margin was just 1.1% of revenues for truckload general freight carriers, 2.2% for specialized truckload carriers and 2.4% for LTL general freight carriers. As stated earlier, 1989 results are expected to be much worse. (These figures exclude United Parcel Service, which is a specialized LTL carrier.)

Thus, even a sustained 12% fuel price increase, as reported by the ICC, that is not matched by freight rate increases would wipe out the profits of the truckload general freight industry. A 20% increase, as is being reported by many carriers, would eliminate the profits of the truckload specialized carriers. A 40% increase, which at the current rate of increase will be surpassed within the next week, would absorb virtually the entire profits of the LTL segment. (See Table 1.)

Clearly, such losses are not sustainable. The trucking industry will be forced to pass along its cost increases.

Table 1
Impact of Fuel Cost Increase by Industry Segment (1988 Data)

Industry Segment	Profit Margin	Fuel Cost as % of Revenue	Profits if Fuel Cost Rose by:		
			10%	20%	30%
Truckload	1.1%	13%	- 0.2%	- 1.5%	- 4.1%
Spec. TL	2.2	11	1.1	0	- 2.2
LTL	2.4	5.5	1.8	1.3	0.2

Source: ATA Statistical Analysis Dept. from Carriers' ICC Reports

Source: ATA Statistical Analysis Dept. from Carriers' ICC Reports

Providing Relief

ATA believes that government intervention in the market for crude oil or petroleum products would be counterproductive. Indeed, the country is still paying for the bungled attempts at market management from the 1970s in the form of less domestic production and refining capacity. Price gouging, however, should not be permitted.

Deregulation of petroleum markets is not complete unless purchasers also are free to respond promptly to oil process signals. For trucking, this requires that carriers be able to pass on their cost increases in a timely manner.

Accordingly, ATA and the Interstate Truckload Carriers Conference, supported by seven other ATA-affiliated conferences, petitioned the ICC on August 3rd to shorten the waiting period for implementing fuel-driven rate increases from seven working days to one day. It is our hope that the ICC will not wait as it did last winter when we filed a similar petition, but will act immediately this time.

Rate decreases can-- and do-- take effect on one day's notice. There is no danger that carriers will maintain higher rates once fuel prices turn around; competition will assure that. The only effect of the seven-working-day rule for rate increases is to force carriers to absorb higher fuel costs (and subsidize shippers in the process) for more than a week each time those

Conclusion

The current wave of fuel price increases is tied to the events in the Persian Gulf and is not yet due to a fuel shortage. While the events in the Middle East will not affect current supplies for many weeks, price gouging began simultaneously with the news reports of the occurrences in the region. Nobody knows how long the current crisis will last.

The government may not be able to do much in the short run to solve the current problems, but it can take action to spare the trucking industry irrevocable harm. First, trucking businesses must be allowed to pass along legitimate cost increases on a timely basis. Second, the ICC can look at means of providing more expeditious and permanent relief. Third, government agencies and Congressional committees can also keep the spotlight on prices. Fourth, and most important for the long run, federal and state governments must open more areas for oil and gas exploration.

Senator BRYAN. Thank you very much, Ms. Batts.

Mr. Rothschild, you recited a rather riveting historical narrative that every time there is an event, whether it is a crisis in the Middle East, an oil tanker spill off Prince William Sound, a refinery that ignites and incapacitates a part of an individual refinery, that immediately we see the shockwave throughout the system. And your point was they have done it before, and they will do it again.

And then you go on to observe that you do not have great confidence that those who are charged with regulating, the FTC and the Justice Department, are really going to do much about it. That is an awfully frustrating message for the American consumer who ultimately pays the cost.

More specifically, is there nothing that we can do at the federal level?

Mr. ROTHSCHILD. Well, I think you mentioned the two things already, which is presidential jawboning and release of the SPR, in coordination with our European and Japanese allies. Because it has to be done and we should not be the only ones exposed at that level. We have got to take that price escalation panic that has now penetrated the market out of it. So that people now can see that there is oil coming into the market, and if they are holding high-priced oil and the possibility that prices might fall, they will start selling off. And we can retard those kinds of fears.

I want to make one point that I forgot to make in my testimony. I think you ought to pay close attention to this so we get some idea of what is at stake. This graph shows the refinery acquisition cost of crude oil from January to July. And you can see it starting to increase in July. The bottom line here would be what margins would have been if they stayed at a reasonable range, roughly 20 cents a gallon, which they usually in normal times.

The top line shows what they actually are, namely the top line is the wholesale price of gasoline. So the margin has grown, and I have labelled this area here as the excess refining margin or consumer overcharge. This is what has happened before recent events. And that is what I was talking about, the structure of the industry. I think we have to deal with the structure of the industry, which is underlying all of these problems. Because when you do not have a very competitive industry, and we heard testimony about the refining level not being very, very competitive, it is not, despite what the American Petroleum Institute might say.

And I think that lends itself to a legislative response for a longer term. I am really frustrated about the federal antitrust enforcement. They did not stop the mergers, which is really one of the serious errors in antitrust enforcement in this country. It may need a legislative response, either at the state or federal level, to open up the market some more, in a variety of ways. And one is fuel economy, so that we do not use as much gasoline. Another is alternate fuels so that there is some competition.

I was shocked to see that the natural gas industry really did not follow through on promoting natural gas as an automotive fuel. The reason, the largest producers of oil are also the largest producers of natural gas. They do not need competition for their automotive fuel. They have already got the market for automotive fuel. But gas would be wonderful, and most of it would be domestic. There is a lot more gas in the United States than there is oil, and we are not even pursuing that.

So I think those are the kinds of efforts we need, both in terms of the structure and increasing the competitive level of the industry through alternatives that would reduce our alliance on oil.

Senator BRYAN. Mr. Rothschild, this is a question that you may not have the answer to, but obviously our focus is what is happening to the American consumer. Is the same thing occurring worldwide? That is, are consumers in Europe and in Japan seeing a rapid run-up in these prices that respond instantaneously to these various events that have such seismic impact worldwide? Or do you know?

Mr. ROTHSCHILD. I can tell you the wholesale prices in Europe have gone up the same way. I do not know what is happening at the retail level. But keep in mind that one of the things that the Europeans have done and the Japanese have done is they have stuck a huge tax on gasoline. So that if you are already paying $2.25 or $2.50, a 5- or 10-cent increase is not all that much to them, because they are already paying such a very high price. Where here, it is much, much greater.

So I do not know what has happened at the retail level in Europe, but certainly at the wholesale level prices have gone up in the same way they have here.

Senator **Bryan**. Yes.

Mr. **Daskal**. Senator Bryan, Jim Daskal from the Service Station Dealers. We think that might be a fruitful area of inquiry to look at what is happening internationally, and particularly in Japan. Kuwait was a large retailer. They have their own stations over there. They call it Q-8 Petroleum. And I think it would be very useful to see what has happened to the retail price in Japan. Granted, it is a different market, but still, the logical assumption would be that if this large retail entity has been taken out of play in that marketplace, that they should be feeling the effects worse than we are.

Senator **Bryan**. Mr. McGilacuddy, you kind of describe yourself and those of you that are involved in your business as being held to the dictates of the big oil companies, and that you are precluded from looking for alternative supplies under the agreements that you have with the oil companies. I guess that is an area that you would like us to take a look at.

Mr. **McGilacuddy**. Yes, sir. We think that that really is kind of basic to the idea of the free marketplace, that you have to have competition. And the very fact that I cannot go to another source for the product means there is no competition at the wholesale level. It is very, very intense at the retail level, and in fact, the service station dealers all across this country get a great deal of assistance from refiner representatives on how they should price their product to be competitive. But when it comes to being competitive themselves, they do not have to be.

And someone said earlier today, it should come as no shock to any of us sitting here that you have this situation, because you have an environment that encourages it. There is no competition at the wholesale level whatsoever. I think that the American motorist is not aware of that, and that is part of our frustration. But, as has been said earlier today, it is a little tough out in that driveway to explain to consumers that are very, very upset a situation that I have no control over, that they assume that we have control over those prices. And the independent service station dealer, when it comes to purchasing his product, is independent in name only.

Senator **Bryan**. Ms. Batts, you are a statistician, and you are indicating that your industry is 5 percent of the total gross national product of this country.

Give me an idea, if you can, regarding a 20-cent-per-gallon increase, which is what you are saying a lot of your truckers are experiencing and which ultimately will be recovered when the posting and the tariff filings become operative—and I understand that the lag time there is a difficulty for you—of what that will translate into in terms of additional costs the American public will have to bear? Do you have a number that you can extrapolate?

Ms. **Batts**. A 20 cent increase, is about 2 percent of our expenses. If we were to maintain a 2 percent profit margin, which is what we have today, you are talking about a 1 to 2 percent increase in our rates. In fact, that is what most carriers are basically looking for.

On different products while the price of transportation can be substantially higher or lower, the prices will ultimately make their way to the consumer, be it in the price of lettuce or in the price of an automobile or, in fact, even in the price of gasoline that they are going to pay, because the ultimate transportation of any petroleum product is always by truck.

The effect of increased truck fuel prices will be there, but it is very difficult to answer unless you could give me some specific commodities. Then I could find out for you. Depending on what the product is, it could be as much as 20 percent of the actual cost of transportation.

Senator **Bryan**. Clearly, you illustrate the rippling effect that this has on the economy.

Ms. **Batts**. Absolutely.

Senator **Bryan**. Let me yield now to Senator Kerry.

Senator **Kerry**. Thank you very much, Mr. Chairman.

Ms. Batts, before I begin my questioning let me thank you for your comments regarding energy and energy use in this country as a whole. I think when America wakes up fully from the oblivion of the 1980's "don't worry, be happy, feel good" mantra, there are many realities with which we are going to come face to face, not the least of which we confront on a daily basis in the situation of our inner cities with drugs, the increase in violence, the homeless problem, the infant mortality problems coupled with our education system and so on ad infinitum, not to mention environmental degradation, et cetera.

Paramount among those avoided realities and choices will be the lack of an energy policy in this country. I think you have highlighted it, as have a couple of other people. I want to try to focus for a minute on the reality of the situation we face right now with respect to oil prices on the rise and the impact on the country at a time when we can really ill afford in terms of our economy and what it means to national security and everything else to have this kind of impact.

Now Mr. Rothschild, I think you are the original author of the law or rule of "the refiner always wins", and I credit you for it. I would like to ask each of you just a short series of questions.

The first question: Is there any question in your mind—is there a legitimate excuse for the increase in the prices in the last few days of gas at the pump in this country?

Mr. Rothschild?

Mr. **Rothschild**. There is no legitimate excuse. I am sure the oil companies have come up with a number of excuses as to how to explain it.

Senator **Kerry**. I understand that.

Mr. **Rothschild**. If you are talking about the fact that we have plenty of oil in storage, the cost factors, the oil from which that gasoline was refined was bought at a much lower price, the companies simply seized the opportunity, in my judgment, so I do not think that is legitimate.

Senator **Kerry**. Ms. Batts, is there any legitimate excuse from your industry's perspective?

Ms. **Batts**. No. We certainly do not price on that basis. If we did, we would have a much higher profit margin than we have today.

Senator **Kerry**. Mr. McGilacuddy?

Mr. **McGilacuddy**. No, sir.

Senator **Kerry**. Mr. Rothschild, is it fair to characterize what has happened as gouging?

Mr. ROTHSCHILD. I had a press conference yesterday, and I was in the headlines. Yes, I think it is price gouging.

Senator KERRY. Ms. Batts, is it price gouging from your perspective?

Ms. BATTS. Yes.

Senator KERRY. Mr. McGilacuddy, is it price gouging?

Mr. MCGILACUDDY. It certainly appears to be, Senator.

Senator KERRY. You are in the business of pumping this gas. It is in your interest to be friendly if you can; correct?

Mr. MCGILACUDDY. Absolutely.

Senator KERRY. Now let us be the devil's advocate a little bit about their perspective. They will claim that the spot market now controls price setting. Is it fair for the spot market to set prices, and does the spot market in fact have an effect on the gas price that consumers are paying now at the pump?

Mr. Rothschild?

Mr. ROTHSCHILD. In the past, Senator Kerry, the spot market was out there, and it did affect prices, but it took a long time before that was translated because there were a lot of contracts out there. Oil companies recognize that the spot market may change because it is volatile. One day it is up; one day it is down. So they were not going to necessarily always follow it because it eventually balanced out.

What you have had recently is that more and more companies live and die by the spot market or the futures market, and a lot of their contracts are tied to it. So they are simply going to turn around and use that as a reference price particularly when the price goes up.

The difference is when the price comes down, there is a long, long delay when those spot prices are not translated to consumers, as we can see from some of the tables in here after the *Exxon Valdez* in 1986 when crude prices came down and in 1988 when crude prices came down.

Senator KERRY. Why would it not be fair for the company to say we have been rolling along at X amount of profit based on current cost to us but we are now looking at a market where in order to purchase our next stock we are going to have to pay X amount, and if we want to keep our current rate of profit in order to purchase that next amount we are now going to raise the price in order that we have the available cash so we maintain our current rate of profit? Would you address that?

Mr. ROTHSCHILD. That is what we call a preemptive strike. It is not much different from what Saddam Hussein did to Kuwait. In other words, they are deciding now to charge higher prices for oil they have not yet received. They certainly can do it. They have been getting away with it. We do not think it is right. When you have an inventory of crude oil bought at different prices, you buy your next load and it gets averaged in.

Senator KERRY. So the analogy would be that if you were a manufacturer of children's toys, for instance, and you have a set of children's toys that are in the pipeline from the manufacturer to you and a little bicycle is being sold for $10, and you look down the road in the future and you say this bike is going to cost $15 because there is going to be a new manufacturing process, you do not start charging $15 for the current bike that is in the store; correct?

Mr. **Rothschild**. You can if you can get away with it.

Senator **Kerry**. Well, that, then, is another question about marketplace. In the free marketplace, when then can they not respond and say, well, this is supply and demand, and the demand is there and people are willing to pay the price?

Mr. **Rothschild**. Your toy analogy is very good, because if that manufacturer sees the $15 price down the road and tries to do it, there are a lot of other toy manufacturers around who will say great, we can get a bigger share of the market, we will keep our prices at $10. That is competition, but that is not what is happening in the oil industry among the major companies.

Their view of competition is if Exxon goes up, then Mobil will go up and then Texaco will go up; we will follow each other up because we will all make more money.

Senator **Kerry**. So the real bottomline point here is that there is a national interest at stake. There is an issue here about overall impact on economy which begs some kind of intervention, if you will, to adjust where the market can be unfair to the consumer. Is that a fair statement?

Mr. **Rothschild**. Absolutely; not just unfair to the consumer but I think it is in the national economic interest to intervene.

Senator **Kerry**. Is it fair to say that there are potential dangers in the steps that have been taken by the oil companies because of the impact on an already troubled economy and what that could do to other matters of security?

Mr. **Rothschild**. Well, certainly to the rest of the economy. Other than the States of Texas, Louisiana and Oklahoma which are now reveling in the higher prices and are going to have good economic times, the rest of the country is much worse off. I think regarding what all the economists have been saying about the rapid rise in oil prices having a very devastating effect on both inflation and recession, if pricing levels continue we will see those forecasts come true.

Senator **Kerry**. Now how does this differ from the impact that might have occurred had the Federal Government been in the position as part of the budget agreement to deal with the deficit of raising gas taxes?

Ms. **Batts**. If I may answer that, certainly from our standpoint we feel that gas taxes should go to the Highway Trust Fund and that those highway trust fund moneys should be spent because we know there is a direct relationship between the productivity in this country and the status and serviceability of our highways.

So from our standpoint, if raise fuel taxes—gasoline and diesel—and if it goes back into the highway system, there is a net benefit to the highway and we certainly benefit directly. That is money that is worthwhile spent.

But to tax the trucking industry and other highway uses to pay for the deficit which was incurred by everyone when at the same time there is a tremendous surplus in the Highway Trust Fund, which came from those same users, is double taxation at its worst.

Finallly, to end up paying that money anyway, and not know where it is going—one assumes it is to the oil industry—really hurts, because that is taking money we had anticipated putting into the Highway Trust Fund next year.

But if I may follow up on a question that you asked earlier, I do think we need to look at what is different with this crisis versus the ones in 1979 and 1973. The one thing which is not parallel is the whole concept of the futures market in oil. We do not really know who plays in that market. You go to Chicago and you watch that market, and you see guys in suits that are 21 years old. Are they the ones that are determining the price? I do not know. The oil companies are certainly in there, but it could be anybody on the street, and quite frankly they never want to take control of that product. That is the last thing they need, is a tanker on their front doorstep.

I think we need to look there, because I think it is being driven by the futures market, and I do not think anybody knows who actually plays in that market.

Senator KERRY. Gordon Gecko without a name.

Ms. BATTS. Gordon Gecko without a name.

Mr. DASKAL. Senator Kerry, our association would like to associate ourselves with that remark. We think this whole business with the spot market is threatening to become a crap shoot with the American economy, because when energy prices go up, it has a multiplier effect on inflation. That was the real cause behind the trauma we faced in the late 1970's. It was not Government policies, it was an oil-induced hyper inflation.

Senator KERRY. Well, I think it is an important issue to lay on the table, and I thank you for your answers, because they have been helpful in just trying to clarify. Thank you, Mr. Chairman.

Senator BRYAN. Thank you very much, Senator Kerry. Senator Robb?

Senator ROBB. Thank you, Mr. Chairman. I am going to ask Mr. McGilacuddy, if I may, to help me understand the specifics of the price changes that have been taking place, and I recognize that you are a representative not only of the Virginia unit but of the national unit, in terms of the various dealer distributors, auto repair and what have you, but I am going to ask you to focus, if you will, on your own station.

If you could, tell me—and use an example. Say, the unleaded, nonpremium gasoline, which may well be the variety that most consumers would buy, but whatever you use, make it consistent.

Take it from Wednesday of last week, and if you could, tell me what your opening price, or closing price, whenever you change on your pumps, is each day, for Wednesday through today. What was the pump price for each of those days, starting with Wednesday, if you could?

Mr. MCGILACUDDY. Wednesday, Thursday and Friday, the pump price was $1.09.9 a gallon. Saturday morning it went to $1.14 a gallon, the result of getting a price increase of 5 cents a gallon overnight, which was uniform. It was not just. the unleaded regular, it was all three grades.

Senator ROBB. So it is still selling for $1.14.9 today?

Mr. MCGILACUDDY. That is correct.

Senator ROBB. You have had in the interim one price increase from the wholesaler that provides your product, is that correct?

Mr. McGILACUDDY. I purchase from the refiner direct, and we had one price increase, that is correct.

Senator ROBB. How often do you take delivery, on average?

Mr. McGILACUDDY. Average is probably every other day.

Senator ROBB. Every other day?

Mr. McGILACUDDY. Every other day.

Senator ROBB. So the price increase that you put into. effect, beginning Saturday morning, I guess, was the direct result of the price increase of 5 cents per gallon. If you buy on the gallonage basis it was a direct pass on at that point, and there are no other intervening factors at that point?

Mr. McGILACUDDY. That is correct.

Senator ROBB. Could you give us some indication of the—and I know this is always awkward to talk about—of the gross prices and mark-up and profits and overhead, and what have you? Can you give us some sense of the relationship between the price you pay and the price you charge your customers? If you can give us a specific dollar figure it would be useful to understand, but even a relationship would be helpful.

Mr. McGILACUDDY. Well, it varies. Let us say—there are a lot of factors, but over the year it might vary from 6 cents a gallon gross profit to as high as 14 cents a gallon, gross profit, but that would be through the year or months, actually. Maybe more than a year.

Senator ROBB. At the present time, which of those extremes are you closer to?

Mr. McGILACUDDY It is closer to 10 cents a gallon. I would say right in the middle.

Senator ROBB. In terms to——

Mr. McGILACUDDY. If I could help you, Senator, the price increase that I received, that is roughly 50 percent of my gross profit. There is no ability for me to try to absorb some of that, and to try to make it up on volume.

Senator ROBB. With respect to some of the other dealers that you represent both in the State and nationally at this particular period, would you say that your experience is fairly typical, that you get product about every other day. Is that true of most retailers?

Mr. McGILACUDDY. Probably. It would vary, but that is probably a good average.

Senator ROBB. Do you have any sense of what the price increases have been for other retailers who have an obligation to buy from other refiners?

Mr. DASKAL. Senator, I am Jim Daskal. The variations have been really all over the lot. We have seen increases of 13 cents out West. Arizona, I think we have seen 17. Here on 'the East Coast we have seen closer to in the 5 to 8 cent range. But I would say you are looking at from a minimum of 5 to a maximum of 17 in the last week.

But at the same time, I can tell you that dealers are hearing from their business counselors that more is on the way.

Mr. McGILACUDDY. I think in Virginia, the information that I had as of this morning is that it ranged from 5 to 9 cents from the different refiners.

Senator ROBB. Have most of those dealers passed on that increase at the time that they received the price increase in either the next delivery or the notification from the refiner, to the best of your knowledge?

Mr. McGILACUDDY. To the best of my knowledge, the lag times were 2 days, 3 days. It was not instantaneous. There were lag times from one retailer to another of when his price increase was passed on.

Senator ROBB. I guess the experience that I am trying to document, if it is indeed the case, is that the prices seem to have increased a couple of times in many cases, and simply looking at it from the highway and comparing prices, which is not a very scientific way, I recognize, but there seem to have been two or three increases during this period.

Would it be your general belief that most of the refiners have passed on during this last 1 week period or less a single price increase to date with more to come, or have there been several smaller incremental increases on their part?

Mr. McGILACUDDY. My refiner passed on one increase with information that there was more to come. Other dealers that I spoke with, their refiners passed on two or three incremental increases since last Wednesday until this morning.

Senator ROBB. Do you have any ability to engage, if you will, in the futures market as others at the wholesale and refinery level can, in terms of locking in a price for the delivery of any particular amount of product in your business?

Mr. McGILACUDDY. Absolutely not. That is a fundamental problem that we have, and if we did have that opportunity, I am not saying that is going to solve the entire problem that everyone is looking at today. But the fact that the dealers do not have that opportunity certainly is contributing to it. There is motor fuel out there at a less cost from one refiner that, if it were available, then perhaps I would buy it, and at least it would slow down some of the escalating price increases by introducing competition.

Mr. ROBB. Ms. Batts, since you are a major purchaser of petroleum product, does your industry have the opportunity to lock in prices, or are you entirely subject to the current delivered price?

Ms. BATTS. There are no trucking companies that I am aware of that own refineries. There was only one that tried it in 1974, and it was disastrous.

Most of my members, if they have their own fuel tanks, have about 2½ days supply, basically, one tank truck load.

As an investor, I assume that there are some trucking companies that could explain the futures market. But nobody plays that market ever wanting to take delivery on what they bought. They are playing the margins. It is just like in the soybeans or pork bellies. Nobody wants to take delivery of that commodity. That is the world's greatest crapgame. That is all that is.

Senator ROBB. So there is no provision for major consumers—i.e. truckers—to lock in any price in the delivered price of petroleum because of their special character as a main consumer?

Ms. BATTS. No. Unless they just want to be an investor, they cannot.

But understand the difference in what is happening, if I could follow on the question there. He was told by his refinery that he has to raise prices because it has gone up, and he was able to do that overnight. My members have to wait 7 working days, and we are absorbing those costs. Unfortunately, the only way we are going to absorb them is right into bankruptcy.

Senator **Robb**. That point is appreciated.

My time has expired. Thank you, Mr. Chairman.

Senator **Bryan**. Thank you very much, Senator Lieberman.

Senator **Lieberman**. Thank you, Mr. Chairman.

Again, I thank all of you on this panel. I think your testimony, each in a separate way, has been very helpful.

Ms. Batts, I just want to go back and highlight two very important points I think you have made through your testimony. One is that this increase in prices is not only trouble for the individual consumer, but when it affects our transportation system, such as the truckers, it is inevitably going to be passed along. What are your people supposed to do? That is going to increase the cost of consumer goods in this country, hurting the consumer more but also creating a problem for our economy generally.

The second point is one that I think is missed sometimes in this whole story. It intrigued me earlier in the year when we did the investigation of the December gasoline price hike; that is, the role of the Mercantile Exchange and the trading of oil futures. This is a complicated business. Unfortunately, there are a lot of hands in this, and there are a lot of different places where we can get ripped off.

It troubles me that something as fundamental and necessary to our society as gas and oil is being subject to speculation on our futures market. This is not the normal product. We live or die, we move or do not move based on the availability and pricing of gasoline and oil.

I think it is time for a full-scale Congressional investigation of this whole question of the way in which oil futures are being traded on an exchange, whether it is appropriate for them to be traded and whether there is adequate regulation of that trading through the Commodities Futures Trading Commission, which is partly why I asked in our letter to the President if the CFTC was to be part of that task force.

Let me just ask this question. Mr. McGilacuddy, I ask this with respect. I think our natural sympathies are much more with the gasoline dealers than with the big oil companies, and not just because you are the folks we see when we go to fill up our own tanks and you are our neighbors and friends but because you do have less latitude. Obviously I think your point about the concentration and the lack of competition at the wholesale level, the level from which you buy, is a very important point here.

Is it true that in this kind of market there is also a natural invitation even for the retailer to raise prices beyond what increase he is being charged?

I will tell you a story which is funny but which makes a point. One of my staff members in Connecticut was driving around over the weekend. I think it was Friday actually. He passed a gas station and saw the station owner changing the price that was marked on the sign outside. He stopped and asked why he was doing it. The guy said, I was just listening to the radio and they were announcing that gas prices are going up all over America, so I figured why not.

Is that not possibly part of the problem? I am not saying it is a major part, but is it not part of the problem here?

Mr. McGilacuddy. That situation exists, and I am relatively sure that it probably has happened across the country somewhere. The real determining factor on that is if a price increase of 5 cents or 6 cents translates to 13 or 14 cents, then the consumer will see a differential in the price on the street at the level where he can make a choice. In other words, an isolated dealer here or there that gets way out of the free market system will correct that very quickly because people will go to the cheaper product, particularly now.

So I think that situation exists, and there is certainly the possibility. I do not think that that contributes to the problem that we have and that we are going to have in the future.

Senator Lieberman. So you think the consumer still has some choice at the retail level? If there is a dealer who is taking advantage of the situation himself and raising prices, the consumer still can shop around for a better price?

Mr. McGilacuddy. Absolutely. The dealer cannot. That is the problem. The dealer has to take the price increase, like it or leave it.

Senator Lieberman. I understand that.

Let me ask you about the price gouging law that I have talked about. I want to make clear that I am not talking about generalized price controls. I do not want to get back into all that, but it just seems to me that we ought to give the President the authority to declare an oil price emergency in cases such as this. We can place in the law a trigger such as a natural disaster, the *Exxon Valdez* or an international crisis like the one we are in now. When that happens, we can give the Attorney General the authority to act to stop profiteering, to punish people with criminal penalties and to seek action to get their money back.

I would like to just go down the list and ask. Mr. Rothschild, what do you think about the proposal?

Frankly, it grows out of the same feeling that you expressed before. We have been here before. The Department of Justice unfortunately does not act under existing law. FTC has not acted, and we are left hearing the same explanations and waiting for the next crisis, and then we will get ripped off again.

Mr. Rothschild. Well, it still leaves discretion at the level of the President of the United States or the Attorney General. Maybe we ought to pursue again some other direction such as a windfall profit tax and maybe define it better than we did in the past but say there is a level beyond which we will determine that that is pure windfall like on inventory profits and simply say that will have to be rolled back or in some way taxed by the Federal Government. That is another way of doing the same thing, but you do not then have to rely on this discretionary authority of the President then to act on that law which was passed by Congress.

Senator Lieberman. You have that little confidence in the process, do you?

Mr. Rothschild. I have been doing this for 20 years, and I tell you that I have been up here many times testifying, doing analyses, and I do have very little confidence. I have more confidence in the State Attorneys General who will act. At least they will act, but they get stuck in the courts for a long time because the oil industry has deep pockets and they hold these things up. We do know that they can act.

In fact, the State of California succeeded in winning a case. I have more confidence in the State Attorneys General than I do in the Federal Government, although they do not have the resources.

Senator LIEBERMAN. Ms. Batts?

Ms. BATTS. I think price gouging is probably one of those things like pornography. We all know it when we see it. We just do not know how to define it.

I certainly do not want to see us go back to the price and wage controls that we had in the early 1970's. I am not particularly enamored with what we saw in the 1970's in terms of allocation regulations. I started out the same time Mr. Rothschild did in this business, and but it was certainly a lot easier dealing with the crisis of 1973 when we had allocation regulations which told us where we had to put the product than we had in 1979 when the way the allocation regulations worked at least for diesel and home heating oil was that if you were using diesel on the highway it was an unregulated commodity, a decontrolled commodity, but if you were using it on the farm it was controlled.

All of a sudden we saw every farmer taking over what we viewed as our diesel. The interesting thing was if you were hauling tomatoes you got fuel, but if you were hauling auto parts you did not. Here was the poor service station attendant, looking at all these truck drivers who looked like they came from the Detroit Lions at some point or another, saying, oh, by the way, you can have fuel but you cannot. They did the only logical thing. They sold everything they had in their tanks and they went south on vacation.

When we understand how long this current situation is going to last, how severe it is going to be and if we start to see availability problems as well as price problems, then we must go back and ask ourselves what did we do right in 1973 and 1979 and what did we do wrong.

The problem today is nobody at the Department of Energy who was around in 1973 and 1979. I am sure, like Mr. Rothschild, I do not want to go through it again. So while I will give you my institutional memory, do not ask me to do much more than that. It was not a very pleasant experience.

There were some things we could learn, and when you do get into the question which goes beyond today in terms of availability, there are some options, and I think we need to at least go back and dust off the books and find out exactly what regulations DOE can implement tomorrow without Congressional authority. Quite frankly, I have asked my staff to start looking at it because I think there are some options we can do if it becomes an availability issue. My guess is we are going to see it become an availability issue much, much quicker than any of us expect.

Senator LIEBERMAN. Mr. McGilacuddy.

Mr. MCGILACUDDY. I would echo the frustration of Mr. Rothschild, that evidently it appears that nothing happens. And I think that once again, if our memories get short again after this particular bump, if there is a big hue and cry and we do nothing about it, we are going to have another one, maybe sooner. But sooner or later there will be more. And each time the consumers and the American public lose.

Individually, I am not a great fan of more regulation and dictating controls and price controls. But I think in this situation, and given the environment that we have in the petroleum industry, that something of that order for the Chief Executive certainly is indicated.

Senator LIEBERMAN. Thank you, thank you Mr. Chairman.

Senator BRYAN. Thank you very much, Senator Lieberman.

We are informed that the next panel is en route over from the other body and so we may ask you to stay for a few more minutes because I think some of us did have some questions, Mr. Rothschild, Ms. Batts, and Mr. McGilacuddy, unless you have a plane.

Mr. ROTHSCHILD. I have another hearing to catch.

Senator BRYAN. Well, in that case we will excuse you, Mr. Rothschild. Thank you very much. May we inquire if Ms. Batts and Mr. McGilacuddy, can you remain a bit longer?

Ms. BATTS. Absolutely.

Mr. McGILACUDDY. Yes, sir.

Senator BRYAN. Let me just pick up on your point, Ms. Batts. You said that none of us want to go through the agony of 1973 and 1979. And I think all of us would agree with that. It was a difficult thing wherever you lived in the country. And in my own State, where we are heavily dependent upon tourism, there was a concern that there would not be the availability of fuel. You drove around on Sunday wondering if there was a gas station that was going to be open. There was a constant fixation to the needle on your gas gauge as to whether or not you ought to go out. And that is something—at least for most of us who only have very dim memories of gas rationing in World War II—is something that we do not want to experience again.

What, in your perspective, did we do right? What did we do wrong from the 1973, 1979 time frame, and can you be a bit more specific as to the kinds of actions that we ought to be taking now?

Ms. BATTS. I feel like Pandora's Box just went open.

Senator BRYAN. You did give me that opportunity.

Ms. BATTS. When I look back at the way my industry had to deal with 1973 and 1979, in 1973 from the standpoint of availability, which ultimately is our crucial issue, there was full allocation regulations on all product. And that within those products there were different allocation levels depending upon the perceived need—and that is a terrible thing to look at—but the perceived need.

Certain groups got 100 percent of current needs while other groups got 100 percent of a baseline. Still other groups got 60 percent, 70 percent, 80 percent of a baseline number. But what happened was at least you could not, within those product mixes, have people transferring product from one group to another.

From the standpoint of diesel, diesel is home heating oil. The only difference is one has a Federal highway tax on it and the other one does not. We can run on home heating oil and they can burn diesel. It hurt truckers who were thrown on the open market in 1979. But the farmers were guaranteed the product when there was a limited availability. If you do that, there has to be limits on all groups or the product just moves where there is no controls.

I am not a real lover of the controls, but 1 recognize what happened in 1973 and what happened in 1979. At least we had options in 1973. We had no options in 1979.

Senator **Bryan**. As a follow-up, you indicate that one of the big differences between the 1973 and 1979 time frame and the present is the futures market. Do you have any thoughts—what ought we to be looking at the congressional level with respect to that market?

Ms. **Batts**. Well, it was interesting, last February, I was out in Chicago and spent a day over at the Futures Commodities Exchange. I kept asking, does anybody really want to take control of this product? And the resounding answer was no, nobody wants to take control of the product.

In fact, at that point, and I do not know if they are still looking at it, was could there be a futures market in the Consumer Price Index? Now if that is not betting, I do not know what is. And there is no product at all in the Consumer Price Index. But there are a group of traders, all sitting there wearing clothes that obviously came from Eddie Bauer or the Banana Republic, sitting there determining if they are going to bet on the Consumer Price Index.

So my sense was just the same kind of concerns that you have. This is a very crucial product. And not to concern yourself on the age of individuals that are involved in this, one wonders if we should put the future of this industry, as energy-dependent as we are, into that kind of an environment.

That was the major difference, in the January price increases. At that point, the people that gained, from our initial analysis, in the January price increase, were not the dealers or truck stops. I do not even think it was the oil companies. I think the only people that gained money were the guys that were trading in the futures market. That is where the billions of dollars went. My guess is that this time around, that is where the billions of dollars are going also.

Senator **Bryan**. Well, what kind of Government interference with the free market ought we to consider, then, if that is the source of the problem as you perceive it—the major difference between the 1973 and 1979 scenario. And you do not come to the subcommittee today as appearing—to be one who is an outspoken advocate of increased regulation, but you do raise a policy question.

If that-kind of control is dictating these kind of results, clearly we cannot simply stand by and do nothing. And to let the economy take the beating that it is likely to take and perhaps create an atmosphere in which a regional recession becomes a national one because of the implication that you have just described in your industry alone, which has 5 percent of the gross national product, what kind of policy intervention would be appropriate in your view, or what policy options ought we to consider? Can you lay out a menu for us?

Ms. **Batts**. Unfortunately I cannot do that. I would just urge that there be some very serious inquiry into how that market works, and to what impact they do have. We need to know more about what is happening in that market. If there is one thing the last 12 months have taught us, however, is that in Central and Eastern Europe, price and wage controls do not work. And I do not want to get back into that. And I do not know if they work in this kind of a crucial market.

But I think we certainly ought to understand what is happening there. And I do not think that outside of a handful of people we have got any real understanding of that market. I wish I could, Senator, but I just cannot answer your question.

Senator BRYAN. Thank you.

Mr. McGilacuddy, you look like you are primed to respond.

Mr. McGILACUDDY. Senator, previously Ms. Batts had mentioned the futures market and people speculating, which certainly they are. She made the statement that none of the speculators want to take delivery of this product. And that is probably true, except that there are players out there that probably would like to take delivery of this product. And they-are precluded from doing so. And that are the service station dealers.

If I could purchase that product and take delivery at a lower cost, I could pass that on to the consumer, be more competitive. But we are precluded from participating in that, and that Co us seems to be a basic wrong and fallacy with the way the petroleum is distributed in this country.

Ms. BATTS. But it is interesting, because we looked atthe futures market. One of the questions I was asking myself was could we get into it to take contr'ol of the commodity. And we said no, nobody plays in this game to ever take control. They would not know what to do with you as an investor if you wanted to take control of the product.

You are in that game to bet whether price is going to go up or down. The futures commodity market was never designed to take control of the product. So I think why you want to get into it and while logically it says you should, that is not what it is there for. It is for investors. It is not to take control of the product.

Mr. McGILACUDDY. I understand that as well. But the question to our industry is, why, if the product is available, we find motor fuel on the spot market while the dealers are precluded and excluded from participating in that?

Our recommendation to the committee—once again, I would echo I am not a strong fan of regulation either, but I think that truly we need to look into how motor fuel is priced, and what the cost of that refined product is.

The refiners' gross profit, while we have discussed it here with Senator Robb of what the service station dealers and what their mark-up is, and you can check the wholesale to the retail—that figure is published every day.

But probably the most closely-guarded secret in this country is the differential to the refiners from that barrel of crude oil. A question that I have, is how much—how many cents a gallon do they make? And I think this committee should look at that. Is there a reason for that wide disparity in the difference between what the retailer pays on the end, keeping in mind that he cannot go out and buy it if it were readily available, and why we have that artificial situation in the marketplace?

Senator **Bryan**. Mr. McGilacuddy, you have raised a pretty good point. As the testimony previously indicated, this is the refinery acquisition cost of crude oil. [Indicating.]

This chart takes us from January through December of the current year. It indicates in January that the crude oil price was about, it looks like, 49 cents a gallon; the gasoline price was somewhere in the range of 70 cents. And as the crude oil price declines, one would expect that the refinery price would decline as well.

In point of fact, as we know, just the opposite has occurred. This is information provided by the Energy Information Administration. That the gap there between the drop in the crude oil and the increase in the refined margin would suggest profit, and profit with a capital "P." That appears to me to be profiteering at the expense of the American consumer. That clearly appears to me to be something we ought to look into.

Let me yield now to Senator Kerry.

Senator **Kerry**. Thank you, Mr. Chairman. I appreciate the panel being willing to stay a little longer. I do not have too many questions more that I would like to ask you. But first, I would like to comment.

Mr. McGilacuddy, I want to associate myself with the comments of Senator Lieberman earlier. I think you folks and the dealers you represent become the unwitting recipients of an awful lot of criticism and anger in the wake of these choices that have been made at levels that you had no control over whatsoever.

And I am very sympathetic for each and every dealer, many of whom we obviously know personally. They are friends. We know them in the community. They are at the front line. In many ways they are sort of the next-to-last on the petroleum food chain, the consumer being the last. And both of them bear the brunt of this in unfortunate ways. Notwithstanding the individual one or two folks that Joe may have referred to who respond, they are still responding spontaneously and understandably to something that has been set into gear by forces much bigger than they are and over which they obviously have very little control.

I think it is important for the public to understand that and not to vent the anger against the dealer who really is trapped in the middle here—not in the middle, at the bottom.

Let me come back to an issue that has been raised here today which I think is a very important one in the context of the kind of crisis we do or do not face with Iraq and Kuwait. I believe that the last longest interruption we had was well underneath the level of planning that has been put into place as a consequence of that interruption; i.e., the strategic petroleum reserve is geared so that given the level of oil that we lose as a consequence of Iraq and Kuwait, there is something like 1,000 days of replenishment from the strategic reserve.

Now, needless to say, there are other considerations in the strategic reserve. It is there precisely for strategic considerations and for other larger cutoffs and emergencies. But it seems to me, given the nature of this particular confrontation, and the potential for replenishment from other sources, and the world's unanimity in its condemnation and isolation of Iraq, that there is a dynamic here which suggests that this does not portend the kind of significant cutoff that argues for a hoarding of the reserve against the potential benefit of releasing some of it to control prices here in the short term.

And I wonder how you would respond to that? Whether or not you think it advisable as a short-term strategy to affect prices by perhaps setting aside a fixed portion and saying we are not going to go any farther than this, but we think this would be very helpful until we can make up the other differences. And then bring the price back down on crude and then replenish it at that lower price.

Is that sensible from your perspective? Or do you not feel that you want to comment on that?

Mr. McGILACUDDY. I am not sure that I am capable to comment on that. I think that that is an option that needs to be looked at. I am not sure in the short term. I guess I would be hesitant to think that that would necessarily bring these prices down or insulate us from any further 5 cent or 10 cent a gallon increases overnight.

Senator KERRY. Ms. Batts, do you want to comment?

Ms. BATTS. The question is whether this just stays limited to Kuwait's and Iraq's oil and how much of that oil we are importing. Also, if there is any incursion into Saudi Arabia.

But I understand we have agreements, treaties, with Europe and Japan that under certain circumstances we would give them some of our oil. So, given the amount of oil these other countries have been importing from Iraq and Kuwait, we could find that we cannot just look at our 1.5 percent and 2 percent, and say it is not going to have any ripple effect. Because if we have to replace oil that Japan was importing—a substantial importer from Kuwait—there will be a ripple effect on our economy, the fact that we do not import that much from Kuwait notwithstanding.

So I think you have to go back and look at some of the things that we looked at back in 1979. I mean, Senator Lieberman's colleague, the late Congressman McKinney, had a three point program which said, we have to establish a strategic petroleum reserve. We have to build a pipeline to get the stuff off the Alaskan North Slope. And at that point, we did not even know what was sitting in ANWR. Then we had to have the Synthetic Fuels Corporation.

What we have to date? We only have one of those things. And we still do not know how we are going to use it. I mean, it is like the individuals that lose their jobs that have their nest egg, and as their kids are starving, say I cannot use my savings because that is for dire emergencies. We do not have any concept of when we are going to use it.

I think we have to go back and look at some of those options that came up. Some of them are crazy ideas, but a lot of them were very good ideas. And I think that Congressman McKinney really had a way to deal with that. All of those things have been lost. They have been lost in the last 15 years.

Senator KERRY. As you know there has been a debate over the years about how to deal with any of the drawdown on the SPR. The Reagan administration, in 1982, had a price competitive sale of SPR oil plan. And it continues to be a matter of tension. I think it is just worth something that we ought to explore.

I also want to say that I am concerned about another hidden impact of this, which is that—and I do not wish any negative impacts whatsoever to a particular part of the country—but the hard reality is that as a consequence of this increase, parts of the Southwest of this country can benefit significantly. Those very same parts of the country happen o be benefiting enormously from the largesse of the national savings and loan bailout right now. So there may be a double infusion of a very significant amount of money to certain parts of this country, particularly at the expense of Northeast on both counts.

Count number 1, fewest failures of S&Ls, but one of the most significant payouts to bailout because of the income level. And count number 2, we are far more dependent on oil than any other part of the country. And so I am going to raise this issue today and simply suggest, as 1 know Senator Lieberman will want to, that we will be particularly focused on this windfall and the question of whether there should be some kind of adjustment to our part of the country as a consequence of it.

I do not have any further questions.

Senator BRYAN. Thank you very much, Senator Kerry.

Senator Lieberman.

Senator LIEBERMAN. I like that idea. I, needless to say, am engaged by the idea that my colleague has suggested. Mr. Rothschild said earlier that there was a potential for a $3 billion windfall profit for the oil companies for the oil that is now in inventory in the United States. And I gather that his number was not gross revenue, but the potential for increased-profit based on the run-up in prices as a result of the Iraq-Kuwait situation. Maybe Senator Kerry has a point here which is that we ought to look at the windfall profits tax again and use it to help us pay for the S&L bailout. That would be a lot fairer to some sections of the country which are near and dear to our hearts.

Let me just make one statement in this extra time that we have and then ask one quick question. I think it has been underlying much of what has been said here, but part of, clearly, why we are here is our anger at what has happened to prices in the last week after Iraq's invasion of Kuwait, which is just absolutely unjustified. These increases bear no relationship to the market.

As we have said over and over again, there is an enormous supply in the pipeline. And individual consumers, dealers, truckers, the American economy is getting ripped off. It is just unfair. But if the international situation does not improve through all that the President and others in our country and the world are trying to do, we are going to face some tough times down the road here.

I hope that part of the message that goes out from these hearings is that oil is' an essential commodity. It seems so obvious, we should not have to say it. Our. society runs one it. Sure, we wish we had more alternative energy., more conservation—we are working on that.

The reality is that we need gas and oil to run this economy. And as a result, if there is real pressure on the world market, we are going to have to have the kind of cooperation between the public and private sectors, between Government and the oil industry, that we have never had before. Or else-there is going to be some very,

very tough legislation passed in Congress. That is my strong feeling.

I hope, as we deal with the short range, today and-the last week, that people in the oil industry, at least, have the longer range American welfare in mind.

Mr. McGilacuddy, I have a very simple question, thinking about all the power and the lack of competitiveness at the wholesaler level. Do you worry that as a result of your statement today, which is pretty strongly negative against the oil industry and the suppliers that you may suffer retaliatory action by your suppliers as one individual gasoline station owner and dealer?

Mr. McGilacuddy. I certainly hope that that is not the case-, Senator. But I realize the magnitude of the statement that I' have made, but it really is very well-known in the industry, it is just not known to the consuming public or to this committee, evidently. But within the petroleum industry, it is a well-known fact that there is no competition at the wholesale level. The refiners are aware of it. And, in fact, the whole pricing structure is set up to perpetuate that.

I just hope that some light is shown in that closet.

Senator Lieberman. Amen and thank you. Mr. Chairman, if I may I would just note for the record, as Senator Kerry indicated earlier in his statement issued on August 2nd—this goes back to another point not responsive to what you just said, Mr. McGilacuddy—the United States strategic petroleum reserve by declaration of the Department of Energy currently contains nearly 590 million barrels of crude oil. So, for once, we have actually done something to prepare for a crisis.

Now the question I want to ask the Department of Energy people when they finally get here is whether they think this is an appropriate time to draw on that supply. According to this release, the Strategic Petroleum Reserve could offset the amount of oil the United States has been importing from both Iraq and Kuwait, which is about 730,000 barrels per day, for over 800 days. So you are talking in excess of 2 years. And that does not include what I have heard described as the 3 months to 5 months supply that is in the inventory of the oil companies right now within the United States.

So we have got some opportunity here to send out a message that there certainly ought not to be panic buying, and that the price increases that are going on are unwarranted. With the Strategic Petroleun Reserve we have some latitude to move new supplies into the market in just the way that we ask the Federal Reserve regularly to adjust the money supply to try to keep interest down. We can move some oil into the market to try to keep the price of gasoline and oil down. This also may keep the panic level down, which unfortunately is fueling—no pun intended—some of the increases that have occurred.

Ms. Batts. Senator, when you get the Energy people here, I think the question that needs to be asked is how much obligation do we have under our international treaties to supply oil to countries that are cut off. I have seen that number, too, but I do not think it has any relationship if we have to make up a 50 percent shortfall in a foreign country. Where is that oil going to come from? It is going to come from us.

So to look at the 800 days supply and say we do not have anything to worry about, is only paying lip service to the concept that we operate in a global economy. If anything has shown us in the last week is that we really do. And that what happens in that region is affecting our prices. The questions that I think you have to ask the oil people and the Energy people is, what impact are those treaties going to have?

My sense is much as happened in 1973 and 1979. If you look at the actual shortage that the United States incurred without those treaties, the impact should have been very minimal. But because of those treaties the impact was substantial. It was the treaty obligations—and I am not advocating we want to get rid them, but we need to understand the impact they have.

Senator **Lieberman**. Tell me again what you understand to be our obligation under those treaties; to whom are we obligated?

Ms. **Batts**. My understanding is that we are obligated to Japan and Western Europe. I hope it is Western Europe, perhaps it is somewhat Central Europe, to make up some shortfalls because we are a tremendous energy producer and they are not energy producers—to make up those shortfalls.

My understanding and recollection, we are going back a number of years, was that if you actually look at what we ended up losing in 1973 and 1979, we could have withstood with very little impact. But it was the treaty obligations which caused a substantial shortage.

Senator **Lieberman**. Do you know, and there is no reason why you should, what we get in return as part of those treaties?

Ms. **Batts**. I do not have the answer to that.

Senator **Lieberman**. Okay. I will ask that question of the DOE representatives.

Actually, I do not have any more questions. Thank you, Mr. Chairman.

Senator **Bryan**. Let the record note that this is a historical first.

Senator **Kerry**. No, no, the first has not occurred. I am going to break that if I might just ask one quick question.

Senator **Bryan**. Senator Kerry?

Senator **Kerry**. It is my understanding that over on the House side, and I would like to get your comment on the record on this, that the statement was made by Texaco, which I will quote: "The vast majority, over 90 percent of Texaco's roughly 6,000 branded retail outlets, are independently owned. Independent businessmen who operate at the retail level and set their own prices, may increase the price of products sold now in order to generate sufficient revenue to cover the higher cost of replacement product."

So, in effect, Texaco is saying, we are not doing it, they are doing it. Here we go, the fingers are being pointed. Retailers are pointing them at the wholesaler, the wholesaler at the retailer, and so forth.

Now, can you respond to that? This is Texaco's testimony. When they get over here I have no doubt that it will be repeated to us, that the retailers are doing this to cover the future cost of their product.

Mr. McGilacuddy. That is not correct, Senator. I think that those independent dealers and independent business people that Texaco has do not have the right to purchase their product, their primary product, from anyone but Texaco at the price that Texaco chooses and in the quantities that Texaco chooses.

Senator Kerry. But could they be doing that, could they be purchasing from Texaco at the price that Texaco chooses and going out and raising their prices at the pump against the potential of the next increase that Texaco will then pass on to them?

Mr. McGilacuddy. That is possible. And I think Senator Lieberman brought that up, or Senator Robb. But the controlling factor there is the consumer. If the Texaco dealer decided to overcharge the public or gouge by double or triple the cost that was passed to him, very quickly his competitors, Exxon, Mobil, and Shell would see an opportunity to sell more of their product. We are not in a shortage situation for allocation yet, so his competition would bring his price down.

Senator Kerry. Well, you say very quickly they would see the opportunity to sell more of their product. You are saying sell more of their product because they keep it at a lower price?

Mr. McGilacuddy. That is correct. The competition would be at a lower price.

Senator Kerry. But that has not, in fact, proven to be what is still working in this particular market, is it? Does not everybody kind of, because there is not that much competition—once there is an excuse to raise prices, is it not more to everybody's advantage just to take the moment, seize the moment? Like Plunkett of Tammany Hall, they have seen their opportunities and they took them.

Mr. McGilacuddy. There is certainly a psychology involved in a market of rising prices and particularly rising gasoline prices. For the dealer, certainly, his number one concern is going to be to recoup the cost of the product today. He may have a tendency to want to recoup artificially depressed profits previously. He may need more profit to cover his overhead that the marketplace has dictated that he could not get previously. There is a tendency to maybe try to take advantage of that, but very, very quickly I would say, I do not think that any of the dealers are raising their prices in anticipation of the replacement cost and profiting by that, because it was stated earlier, we purchase on the average of every other day. So the inventories—any windfall profit of pumping up your inventory is very quickly dissipated because your inventory is gone in a day and a half.

Senator Kerry. Ms. Batts, do you have any comment on that?

Ms. Batts. I do not have any expertise in that area, sir.

Senator Kerry. Okay. Is it your sense, and I am beginning to feel I am really looking forward—I hope we are going to get these folks here from the companies because they are so key to this whole dialogue, obviously. But I have this premonition that we are going to be winding up in a situation as Mr. Rothschild has said, he has seen it for 20 years, and you have seen it for a lot of years, where the fingers are going like this.

[Indicating.]

Senator Kerry. It is that way. And meanwhile the consumer is shelling out, shelling out, shelling out, angrier, and angrier, and angrier. That brings us back to the original proposition of Senator Lieberman, which both Senator Bryan and I gladly joined in with, which is the notion that the President has really got to step in here and exert some kind of quick factfinding authority and very quick leverage to whatever degree he can in order to try to sort this out. I am not sure it can happen any other way.

Would you say that is a fair assessment?

Ms. **Batts**. I think we certainly have to know the facts. I just hope we do not spend a lot of time waiting for those to come out and end up with a typical Government report which says there needs to be more research.

Senator **Kerry**. Well, this is not very complicated.

Ms. **Batts**. No, it is not.

Senator **Kerry**. It seems to me we could get the facts on this in a day or two. It is a matter of a few telephone calls about who is charging what and where and what the price is versus the crude and what the supplies are. And DOE is supposed to have that anyway. So if you cannot come up with a memorandum to the President that suggests that within a day, then we should not be wasting the kind of money that is going into half of the agencies that are there to discern those things.

So, I am not sure it is that complicated. That is different, incidentally, from the rulemaking, factfinding process of the FTC or something. This is a matter of policy.

Ms. **Batts**. I would agree with you. However, if one remembers back in January when hearings were held over on the House side, those very questions were asked and they could not find the answer short of 3 or 4 months from the Department of Energy and their Energy Information Office. So hopefully, they have changed their reporting requirements and can get that kind of information.

The one thing I do not think we want to do is to make policy on the base of anecdotal data. We do have to have good data, and bad data are worse than no data.

Senator **Kerry**. Would you consider it purely anecdotal if you had in your hands the price that the refiner is charging, if there is a middle person wholesaler, to the middle person wholesaler and then to the retailer, or if directly to the retailer, you had that price. And then you know what is happening at the pump; you have got a pretty accurate picture at that point. Do you not?

Ms. **Batts**. I think that is pretty easy. But the question you want to ask is to make sure you have a large enough sample that you want to draw on. I would agree with you, I do not think there is any reason why you could not have that.

Senator **Kerry**. Well, we have got more than one telephone in this government.

Ms. **Batts**. You are absolutely correct, and there is no reason why they could not find that data very quickly.

Senator **Kerry**. Thank you, Mr. Chairman.

Senator **Bryan**. Thank you very much, Senator.

I believe that we have our third panel here joining us. Mr. Glenn Tilton, who is the President of Texaco Refining. Let me just say before the panel leaves, we thank you very much, Mr. McGilacuddy, and you, Ms. Batts, for your testimony. It was helpful. We recognize it was on short notice, but we appreciated the candor of your responses to our questions.

Mr. Glenn Tilton, President of Texaco Refining and Marketing, joins us this morning, as does Mr. Charles J. DiBona, President of the American Petroleum Institute. Is he not here yet? If he has not, maybe we can give you a moment to get yourselves situated.

Mr. Phillip R. Chisholm, the Executive Vice President of Petroleum Marketers Association of America. We understand that you gentlemen have just left a previous hearing in the House, and so let us give you a moment to get yourselves situated if I may.

[Pause.]

Senator BRYAN. Mr. Chisholm, I know that you are going to be joined by your co-panelists in just a moment. Perhaps in the interest of time—oh, I see they are here. I presume that we have the honor of Mr. Glenn Tilton, who is the President of Texaco, who joins us, and Mr. Charles J. DiBona, who I believe is on his way.

As I have previously acknowledged, Mr. Tilton, we know that you have been testifying in the other body, and I understand the nature of the delay.

Mr. TILTON. Thank you, Senator.

Senator BRYAN. Mr. Chisholm, why do not I give you the opportunity. We have prepared statements that we have received, and in the interest of your time as well as the opportunity of the panel, to ask you some questions, let us ask you if you would, to limit your testimony to five minutes, and then in the colloquy we will have a chance to respond, and you will be given a chance to amplify or embellish any of the comments that you have.

So let me tender the floor to you now, if I may, Mr. Chisholm.

STATEMENT OF PHILLIP R. CHISHOLM, EXECUTIVE VICE PRESIDENT, PETROLEUM MARKETERS ASSOCIATION OF AMERICA

Mr. CHISHOLM. Thank you very much, Mr. Chairman.

My name is Phillip R. Chisholm. I am the Executive Vice President of the Petroleum Marketers Association of America. PMAA is a federation of some 44 state and regional associations that represent some 11,500 independent petroleum product marketers nationwide. Collectively, these marketers sell roughly half the gasoline and three-quarters of the home heating oil and about 60 percent of the diesel fuel that is consumed annually in the U.S.

I should begin by noting that PMAA is as concerned as many members of this committee and the consumer populace as the recent price increases. Since August 1st, PMAA has received anecdotal information of wholesale price increases ranging anywhere from 8 cents a gallon to 25 cents a gallon in the course of the last week.

I also understand that there are some wholesale price increases that are being made even now as we speak. Attached to my testimony is the wholesale prices for four dates, July 3rd, July 15th, August 1st, and August 5th or 6th at a terminal in Pennsylvania for four different suppliers, which gives you a sample of the types of price increases the wholesalers have been feeling.

The major concerns that PMAA has with the price increases, just in terms of their members' interest, is that the higher prices lead to higher inventory and higher operating costs for many wholesalers and retailers throughout the industry. Another major problem we have in connection with that is that many marketers are diversified into other businesses. And money spent on higher gasoline or petroleum prices leaves less disposable income for other purchases.

In addition, petroleum marketers, because the price increases are occurring as rapidly as they are, in many cases are not able to able pass those through as quickly as they receive them. So, as a result, they have to absorb some of those price increases in some instances.

And the final reason we are concerned about the price increases is that our members are on the front line. They are the people who deal most directly with consumers. And they are seeing the anger and frustration that I know many of you are seeing as elected leaders.

In addition to the price hikes, there is a problem associated with supply. And in addition to increasing prices, many suppliers have put certain restrictions on the amount of supply that my members can purchase. Generally, those restrictions relate to the contract volumes that they have provided in their contract. And while in normal situations that would not be a problem, in agricultural areas heavily dependent on diesel fuel, it could present a real problem this summer if the situation persists.

And specifically, a marketer may have a contract for a million gallons of diesel fuel; but he may sell the bulk of that diesel fuel in the five-month period between May and September, when crops are planted and harvested. That creates a real problem in terms of being able to get the supply you need if you are on some type of supply restriction from your supplier.

Now having said all of that, let us talk a little bit about why this may be occurring. And by now everyone has heard pretty much that the oil market is a commodities market. It is a commodities driven market, more so than it has ever been in the past. And there are those who would argue that the recent increases in crude oil prices that have occurred as a result of the Iraqi invasion of Kuwait really should not be felt in the retail market at the current time.

I think, in reality; what we are seeing is that the market has been taken over by fear and panic throughout the entire system. I think people watched the invasion. They saw the New York Merc prices increase immediately the next day. They saw the spot market prices increase immediately after that. And as a result, everybody saw gasoline and heating oil become a more valuable commodity. And that extended not only throughout the industry, but to the consumer level as well. Consumers wanted to fill up their tank and beat the next price increase with both gasoline, and with home heating oil to a large extent as well.

So there was this consumer reaction that drove up demand, and a psychological reaction on the part of many people in the industry that prices are going to be higher, so let us stock up and build inventories at this particular point in time.

I do not think you can relate the price increases to crude oil. And I think more and more, if you look at what has happened over the last 18 months, you have had three price disruptions, one related to the *Exxon Valdez,* one related to the heating oil crisis last winter, and this one, and none of them have been directly influenced by the availability of crude oil. There has generally been crude oil available in each one of those instances. It has been a problem for the infrastructure, the refiners, the distribution networks, the terminals, the storage facilities, to get the product where it is needed, when it is needed.

So I do not think we would join the parade—in fact, I know we would not join the parade of those who would say that what we are seeing now is price gouging and rip-offs. I have tried to put myself in the place of every individual in the distribution system, from refinery down to the consumer. And I suspect my behavior in each one of the instances would track the behavior that we have actually witnessed. And that is the type of behavior you are going to witness probably in any commodities market you do business with or you try to deal with in the future.

I have said to myself, what if I was the good oil company, and what if I was the oil company who decided not to raise my prices, and to keep my prices where they were and wait for the crude to get here before I raised my prices. And I said, if I did that, what would happen. And what would happen is I would be able to offer the consumers a lower price. And as soon as I offered the consumers a lower price, consumers would flock to my service station, and it would not be long before I would be out of fuel. And then I would have to close the service station and wait for another source of supply someplace.

And that is the problem you have got. Anybody who does not price its product competitively is going to see its supply drained, and as a result, they are going to run out of product. I know the committee had several questions, and I will end there and yield my time to Mr. DiBona and Mr. Tilton.

[The statement follows:]

STATEMENT OF PHIL CHISHOLM, EXECUTIVE VICE PRESIDENT OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

Good morning Mr. Chairman and members of the subcommittee. My name is Phillip R. Chisholm and I am the executive vice president of the Petroleum Marketers Association of America (PMAA). PMAA is a federation of 44 State and regional trade associations which represent some 11,000 small independent petroleum product marketers nationwide. Collectively, these marketers sell half the gasoline, three quarters of the home heating oil and over 60 percent of the diesel fuel consumed in the U.S. annually. I appreciate the opportunity to be here this morning to offer the perspectives of the independent petroleum marketers on the events of the past week as they regard increases in the prices of petroleum products.

I should begin by noting that PMAA shares your concerns with the rapid price rises that have occurred sine the Iraqi invasion into Kuwait. Since August 1 PMAA has received anecdotal reports from marketers of their costs of gasoline, diesel fuel and home heating oil increasing from 8 to 25 cents per gallon at the wholesale level. Increases of 10 to 15 cents are common place, and I understand that wholesale prices are continuing to rise at some terminals even as we speak. Attached to these remarks is a chart of how the prices have increased for a typical marketer at a common terminal in Pennsylvania over the course of the last month.

These price increases present an enormous problem for marketers for several reasons. First, higher prices lead to higher operating costs for marketers including the costs of money to finance inventory. Secondly, many marketers are in diversified business related to the petroleum products that they sell, such as a convenience store which sells gasoline. Higher prices for petroleum products lead to less disposable income to spend on other items the consumer may wish to purchase from the marketer. Third, historically, marketers enjoy greater profitability in their business when prices are falling, not rising. This occurs because in periods, such as this, with substantial price increases on a daily basis, many marketers are forced to absorb part of these increases. Finally, marketers are the most direct link with the ultimate consumer of the product. They are on the firing line, and as such are the prime recipients of consumer frustration and anger over the price hikes.

In the addition to the price hikes, another problem has arisen related to supply. Many companies have instituted restrictions on the supply available to independent marketers. For the most part these restrictions will allow the marketer to purchase the amount he is contracted to purchase and either forbid purchases in excess of the contract volumes or place an additional premium of as much as 10 cents a gallon on purchases in excess of the contract. This policy presents a significant problem in agricultural regions of the country where a marketer may sell 80 percent of this annual volume of diesel fuel in the 5-month, spring-to-fall planting and harvest season. This policy may place a disproportionate burden on farmers who not only have to pay higher prices but may encounter some problems with supply availability if these policies persist.

With this background, one might expect PMAA to join the rising tide of criticism directed at the major oil companies for these price increases and supply policies. While PMAA has often criticized suppliers on such issues, we can not jump on the bandwagon in this particular instance. While we hear the cries of price gouging by consumer advocates and elected officials and that calls for investigations by virtually everyone, I would argue that gouging is not occurring and the investigation would be necessary only if the market had not acted precisely as it has.

By now everyone has heard the fact that the petroleum industry has, for the most part, become a commodities market. Those who argue that the recent increases in crude oil prices should not have been felt by domestic refiners are correct. However, the dynamics of this market or any commodities market can not be explained so easily. These markets are generally ruled by a perception of what is happening or what may soon happen to a given commodity, in this case petroleum products.

Clearly the perception since last Thursday evening when the invasion occurred is that the price of oil will be going up. This perception was reinforced when the futures price for gasoline and heating oil increased substantially on Friday and the wholesale spot market followed the futures market. This led consumers to increase their purchases of petroleum products to avoid future retail price increases. This increase in demand rippled throughout the entire system and caused every segment of the petroleum industry to react the way any industry reacts when demand increases—prices are raised.

The petroleum industry has changed dramatically in the last 10 years. While crude oil remains an important component in the final price consumers pay for gasoline it is less important than it has been historically. To realize this, one needs only to review the events of the past 18 months. Three times during that period prices have increased dramatically almost overnight. The first time was the aftermath of the *Exxon Valdez* disaster. The second time was last winters rise in distillate price fueled by the abnormally cold weather. Finally we have the current situation.

There is one common fact in each of these cases. In every instance there was not a physical shortage of crude oil. The increases in prices dealt primarily with the perception of the availability of petroleum products over the short term. The perception was negative and was reinforced by the eroding infrastructure of our industry.

No new refineries are being built and existing refineries are operating at capacity. Terminals which stock inventory of products are being taken out of service because of increasingly stringent environmental regulation. Finally at the retail and wholesale storage levels service stations and bulk plants are closing again, as a result of their inability to remain economic in light of the new environmental regulations. All of this leads to a single conclusion. Our supply and demand for petroleum products is an extremely delicate balance. The margin for error is less than it has ever been before. As a result a more volatile market exists for all petroleum products.

Is this bad news for the consumer? Yes and No. In the last 18 months when the prices have gone up dramatically the same volatility that drove them up also drove them back down again. In fact, the real prices of petroleum products fell as free market forces replaced the Government price and allocation system of the 1970's. The bad news is that the infrastructure of the industry is eroding seriously and given the provisions of the clean air amendments the situation is likely to get worse not better. This may be a subject worthy of investigation or at least further study.

Does this mean that consumers can do nothing to control their destiny? Absolutely not. In the current situation, the best advise I can give is to not panic. By rushing to buy petroleum products now because they think the price is going to go even higher, consumers will be fueling the demand surge that has helped lead to the price increases that have been experienced thus far.

I would also recommend consumers use the same tactics they did when petroleum prices shot up in the 1970's—conservation. If we learned anything from our experiences then it was that conservation will lower demand and hence prices. Finally, consumers should take advantage of something that is almost unique to the petroleum industry. They have the option to shop for the best value in the marketplace by driving down the street and seeing huge price signs posted which advertise prices at that station. if a particular station is not competitive, go to another one.

I appreciate the opportunity to appear this morning and I will be happy to attempt to respond to any questions.

MOBIL (MALVERN, PA) TERMINAL

	July 3	July 16	August 1	August 5
Regular unleaded	66.00	66.05	69.45	75.45
Premium unleaded	79.50	80.55	83.95	89.95
Diesel fuel	51.65	54.65	61.05	72.55
Heating oil	48.65	51.65	58.05	69.55

ASHLAND (MALVERN, PA) TERMINAL

	July 3	July 17	August 2	August 6
Regular unleaded	65.4	67.75	75.5	85.5
Premium unleaded	75.4	79.75	87.5	97.5

BP (MALVERN, PA) TERMINAL

	July 3	July 17	August 1	August 6
Regular unleaded	65.45	68.45	66.95	85.45
Premium unleaded	78.00	84.00	80.00	98.50
Heating oil	50.10	55.90	58.85	78.40

CITGO (MALVERN, PA) TERMINAL

	July 3	July 17	August 1	August 6
Regular unleaded	66.15	67.35	68.75	79.75
Premium unleaded	78.65	79.85	82.25	93.25
Heating oil	50.65	57.95	60.25	80.25

Senator **Bryan**. Thank you very much, Mr. Chisholm. Mr. Tilton, we will hear next from you. And your prepared testimony, as well as your other co-panelists, will be made a part of the record, so feel free to depart from it if you care to do so. And as with Mr. Chisholm, we would like to ask you to confine your opening statements to 5 minutes so that we might be able to respond and question you on anything that comes to our mind as a result of what you have to say.

STATEMENT OF GLENN F. TILTON, PRESIDENT, TEXACO REFINING AND MARKETING INC.

Mr. TILTON. Thank you very much, Mr. Chairman. My name is Glenn Tilton. I am the president of Texaco Refining and Marketing. We are pleased to have the opportunity to be here today to speak to the issues from the perspective of our 7 percent market share in the United States and our seven refineries across the United States, which we own and operate jointly with our joint venture on the East Coast of the United States, Star Enterprise.

To Mr. Chisholm's point, the rising price of oil and product has an immediate effect on this market today because the purchase price is, in the view of a good oil company, in a substantial number of cases set on the date and time of delivery. So a load of oil or products shipped from the Persian Gulf several weeks ago and arriving at a U.S. port today is often paid for at today's market price, prices that are strongly influenced by the New York Mercantile Exchange.

The American public is understandably confused—

Senator KERRY. Would you pull the microphone a little closer, please?

Mr. TILTON. Yes. I will do that. The American public is understandably confused on this particular point, thinking that oil delivered to the United States from the Middle East, as Mr. Chisholm suggested, would have been purchased weeks before at the then prevailing price, or supplied out of existing inventory.

These are critical points to consider. To repeat: significant market influencing quantities of oil and product entering U.S. refineries or distribution systems today, are paid for at current market prices, not the price of 45 days ago. Also, much of the inventory that has been recently reported to have been available was, in fact, on ships at sea and unavailable.

Let me turn now and briefly explain why we view prices escalating in the recent weeks. As Mr. Chisholm has said, supply and demand in commodity markets is, of course, heavily influenced by anticipation. Iraqi pressures on OPEC price meetings, followed by the invasion of Kuwait by Iraq and the embargo of Iraqi and Kuwaiti crude oil threaten to reduce future oil supplies. These events have led to increased crude oil and product prices on world commodity markets. These increases, of course, are passed along through the various channels of distribution, ultimately to the retail level.

Previous unrecovered cost increases have been in the system since early July when crude prices, then at $17, approximately, per barrel, started to increase in anticipation of the OPEC price meeting. The average retail price of regular unleaded gasoline across the United States in early July was about $1.05 a gallon. Since Iraq's invasion of Kuwait on August 1, the price per barrel of crude has risen to $28.05 as of yesterday on the New York Mercantile Exchange. That is an increase of about $11 per barrel over the early July price. Meanwhile, Texaco's delivered price to resalers has increased approximately, on average, 8 cents across the United States.

Crude oil prices have risen more than 50 percent since early July, retail prices have gone up significantly less, indicating that refiners are currently not yet recovering in the marketplace a significant portion of crude oil costs incurred since the beginning of July.

As we all know, the United States is not currently self-sufficient in petroleum. We import about 50 percent of our requirements. A significant portion of these imports is in the form of refined products. Any refiner or marketer committed to keeping its customers fully supplied with product must be willing to pay prevailing world prices for raw materials and for product imports.

For example, Texaco produces 830,000 barrels a day of crude oil and liquids. We refine 1,440,000 barrels a day. We sell 2,125,000 barrels a day. Thus, 60 percent of what Texaco sells is purchased on the open market at prevailing prices.

In addition, the vast majority, over 90 percent, of Texaco's roughly 16,000 branded retail outlets are independently owned, independent businessmen who operate at a retail level and set their prices accordingly.

You will recall that we pointed to the same competitive market forces at work last winter when the American public exhibited its concern over a dramatic increase in home heating oil prices. The problem then was bitter cold weather which increased demand and tightened supply, causing heating oil prices to rise. You will recall that operating difficulties in the transportation and refining sectors exacerbated the problem. At that time, industry critics contended the oil companies were price gouging and taking advantage of the situation, not that market forces were indeed at work causing prices to rise.

In response to specific congressional requests to determine the facts of the home heating oil price increases, the. U.S. Energy Information Administration conducted a recently released exhaustive study into the causes of the home heating oil price increase last winter. The conclusion was that the market was driven by natural forces in response to an extraordinarily cold December in 1989. Higher prices for home heating oil were driven by market forces as the industry contended all along, and not by collusion.

I will sum up, Mr. Chairman, by saying that Texaco in its guiding principles values its customers. We value them in the context of long-term relationships. We value them today. We want them to be with us tomorrow. It serves us no useful purposes to price our retailers, wholesalers and resalers out a very competitive market.

And I will reiterate that while the opportunity has been upon us to take advantage of the situation, the actual posted prices by Texaco in the marketplace at 8 cents, on average, have significantly lagged not only the runup in crude price, Mr. Chairman, but also the runup in product price as quoted on the New York Mercantile Exchange.

We faced a situation in the marketplace yesterday where our managers woke to the prospect of an increase of product price on the New York Mercantile Exchange of 9.3 cents. In no market across the United States did we even begin to recover that increase.

I will pass then over to Mr. DiBona.

[The statement follows:]

STATEMENT OF GLENN F. TILTON, PRESIDENT, TEXACO REFINING AND MARKETING INC.

Thank you, Mr. Chairman and members of the committee.

My name is Glenn Tilton and I am President of Texaco Refining and Marketing Inc.

Crude oil and petroleum products are commodities and their wholesale prices are determined in commodity markets, just as in the price of grain, for example. The driving mechanism of that competitive marketplace is the law of supply and demand.

The rising price of oil and product has an instantaneous effect on the market because the purchase price is, in a substantial number of cases, set on the date of delivery. So the loan of oil or product shipped from the Persian Gulf several weeks ago and arriving at a U.S. port today is most often paid for at today's market price—prices strongly influenced by the Mercantile Exchange. The American public is understandably confused on this point, thinking that oil delivered to the U.S. from the Middle East would have been purchased weeks before at the then-prevailing price or supplied out of inventory. These are critical points. To repeat: market-influencing quantities of oil and product entering U.S. refineries or distribution systems today are paid for at current market price, not the price 45 or more days ago. Also, much of the inventory reported to have been available was on ships at sea and as yet unpriced.

Let me turn now to why the prices of oil and refined products have increased in recent weeks. Supply and demand in commodity markets is, of course, heavily influenced by anticipation. Iraqi pressures on OPEC pricing meetings, followed by the invasion of Kuwait by Iraq and the embargo of Iraqi and Kuwaiti crude oil threaten to reduce oil supplies. These events have led to increased crude oil and product prices on world commodity markets. These increases, of course, are passed along through the various channels of distribution to the retail level in a competitive marketplace.

Prior unrecovered cost increases have been in the system since early July when crude prices, then at $17 per barrel, started to increase in anticipation of the OPEC price meeting. The average retail price of regular unleaded gasoline across the U.S. in early July was about $1.05 per gallon. Since Iraq's invasion of Kuwait on August 1, the price per barrel of crude had risen to $28.05 per barrel by Monday, August 6, an increase of about $11 per barrel over the early July price. Meanwhile Texaco's delivered price to resellers has increased approximately 8 cents a gallon in the last month.

Crude oil prices have risen more than 50 percent since early July, while retail prices have gone up much less, indicating that refiners are currently not yet recovering in the marketplace a significant portion of crude oil cost increases they have incurred since early July.

The U.S. is not currently self-sufficient in petroleum; it imports about 50 percent of its oil needs. A significant portion of those imports is in the form of refined products. Any refiner or marketer committed to keeping its customers fully supplied with product must be willing to pay prevailing world prices for raw materials and for refined products.

Texaco produces 830,000 barrels a day of crude oil and liquids, refines 1,440,000 barrels a day and sells 2,125,000 barrels a day. Sixty percent of what Texaco sells, in other words, is purchased on the open market at prevailing prices.

The vast majority (over 90 percent) of Texaco's roughly 16,000 branded retail outlets are independently owned. Independent businessmen who operate at the retail level and set their own prices may increase the price of product sold now in order to generate sufficient revenue to cover the higher cost of replacement product.

Oil companies pointed to the same competitive market forces at work last winter, when the American public exhibited its concern over a dramatic increase in home heating oil prices. The problem then was bitter cold weather, which increased demand and tightened supplies, causing heating oil prices to rise. Operating difficulties in the transportation and refining sectors worsened the situation.

At that time, industry critics contended that oil companies were price-gouging and taking advantage of the situation—not that market forces were indeed at work, causing prices to rise. In response to Congressional requests to determine the facts of the home heating oil price increases, the U.S. Energy Information Administration conducted a just-now-released exhaustive study into the causes of the home heating oil price increase last winter. The EIA concluded that the market then was driven by natural forces in response to an extraordinarily cold December of 1989. Higher prices for home heating oil were driven by market forces, as the oil industry contended all along, and not by any sort of collusion or gouging.

Texaco's "Guiding Principles" call for the delivery to customers of products of "proven high quality at fair prices and to serve them in such a manner as to earn their continuing respect, confidence and loyalty, both before and after sale."

Following these principles, Texaco will use its best efforts to keep its customers supplied with petroleum products in these difficult circumstances. We will price our products daily. Our prices, however, must include the increased cost of crude oil and product purchased from third parties to provide the funds necessary to obtain replacement supplies of crude oil and products to run our business on an ongoing basis.

Texaco's exploration, production, refining, marketing and transportation efforts are dedicated to finding, producing and acquiring supplies of crude oil and refined products throughout the world to supply our customers. Experience has shown that competitive market forces provide the best and most effective system of supplying energy markets. Government intervention in the form of price controls and allocation systems in the 1970's created costly supply disruptions and shortages. With government and industry working together in a free market setting, we will have the best prospects for meeting our country's energy needs during this period of supply disruption.

Senator BRYAN. Thank you very much, Mr. Tilton. And we will now hear from you, Mr. DiBona.

STATEMENT BY CHARLES J. DiBONA, PRESIDENT, AMERICAN PETROLEUM INSTITUTE

Mr. DiBONA. Thank you, Mr. Chairman. I appreciate the opportunity to appear before you today. My written testimony covers three basic areas. First, the recent behavior of crude oil and gasoline supply and demand and their impact on market prices; second, the situation in the Middle East and what it could portend for the future; and third, possible policy choices and their impact on the future supply and demand situation.

In the interest of time, I will focus on the first area in my oral statement, and if I have time, say a few words about the last two.

The overall increase in world production earlier this year put downward pressure on crude prices until about two months ago when market participants began anticipating increased OPEC efforts to bring supplies into line with demand. This took spot price crude prices from about $15.50 per barrel in mid-June to about $20.00 per barrel by the end of July, just prior to the Iraqi invasion of Kuwait. Since the invasion, crude oil spot prices increased by a further $8 per barrel as of the close of the spot market yesterday.

In the gasoline market, U.S. refiners have been operating at close to 100 percent of their effect capacity over the past several weeks, averaging 7.4 million barrels per day and have been importing gasoline at very high levels as well.

Since the beginning of the crude oil price increase seven weeks ago, gasoline prices also have risen, though by less. In fact, from mid-June to August 3, crude oil spot prices rose some 21 cents per gallon while spot gasoline prices rose by about 11 cents per gallon. Thus, refiners selling into the spot market have not fully recovered spot crude oil price increases over that period. These data cover the six weeks until August 3, and the data of yesterday further confirm that.

Recent events indicate that prices can move very quickly when world market conditions change. There are a number of reasons why prices may move more quickly than in the past.

First, an increasing amount of trade has been occurring on spot markets. To a gasoline supplier buying on the spot market, costs of supply change with the spot price and hence are passed through almost instantaneously.

Second, the very existence of spot and futures markets in recent years has made price information more widely available. One result is that contract prices are often now tied to the spot prices.

Finally, much crude is now bought on terms in which prices are set by the spot market at the time of delivery in the United States, not the price at the time of loading a month or so earlier.

Despite all of this, average prices tend to move more slowly than spot, as these are a combination of longer term contracts as well as immediate transactions. For example, over the period July 17 to August 3, national average refinery rack prices for seven of the largest companies increased by 3 to 5 cents per gallon even as spot gasoline prices increased by nearly twice this amount.

One criticism heard of petroleum prices is that they reflect future rather than past conditions. Thus, for example, refiners are criticized for increasing gasoline prices as supplies tighten relative to demand on grounds that conditions occurring when the crude was bought did not reflect such tightening.

This reflects a naive and one-sided view of how markets work. First, if any one refiner held prices down in the face of tightening supply/demand conditions, while others—say those purchasing supplies on the spot market—raised their prices, that company quickly would have its tanks emptied.

In a competitive market, selling prices must reflect today's supply/demand conditions, including perceptions of what the future holds, which is best reflected by the actions of hundreds of participants in the spot market. Anyone selling above or below either will have too few or too many customers.

Second, this criticism fails to account for the reverse phenomenon, when selling prices suddenly fall. Last winter, for example, U.S. refiners aggressively sought home heating oil supplies in world markets during the very cold spell that we experienced in December.

These supplies were purchased at premium prices and were delivered in January, when the weather became extraordinarily warn and prices plummeted, so the oil companies who bought could not recover their costs, losing out on the risk that they had taken in supplying previously increased demand.

Now, with regard to the supply situation, if there were a totally effective boycott of Iraqi and Kuwaiti crude, it would affect total world supply by about 4 million barrels per day, which is about 8 percent of world supply. At the same time, there is about 4 million barrels per day of additional capacity not currently used in the world.

Unfortunately, 3 million of that is in the Persian Gulf. If those countries are unwilling to increase their supply, but we did get supplies from producers outside of the Persian Gulf, we would have a net shortfall of 3 million barrels per day. That is about 6 percent of free world supplies.

To give you some sense of the amount that that implies in a historical context, in 1973 the world was short initially about 4½ million barrels a day, about 1½ times this volume, and in 1979 when we also had gasoline lines, the world was short about 2 million barrels. So this level, if there were a totally successful boycott but you got one million barrels from other places, would result in a level between the 1973 and 1979 levels of loss. Those had remarkable and direct impacts on markets, as we all know.

Our view is that the worst possible way to have dealt with those was to have established price and allocation controls in the United States. Those led to gasoline lines, did not let markets adjust, and led to many of the problems we had.

Given the steps that we currently can take, we believe this is not a time for panic. We now have what we did not have in the 1970's, a very large petroleum reserve, and releases from that reserve could be made for a long period of time. In addition, the fact that the price has risen will curtail some demand in the world and that could be a fairly substantial impact.

We can also take some immediate steps and some longer run steps. The immediate steps would be to do such things as to permit the production of oil in Point Arguello—off the California coast, at a place that already has been drilled. The facility is ready to operate. It could produce 80,000 barrels a day, and for 2 years it has been sitting, waiting for a permit to off-load the oil.

In addition to that, EPA has recently imposed certain reductions in the vapor pressure of gasoline throughout the country. That adds about 150,000 barrels a day to our crude demand, and one could ask the question whether you may want to temporarily relieve such a constraint.

In the longer run there are questions that have to be answered, because part of our problem is generated by the fact that we are demanding or importing so much oil. Those are questions about the ANWR; the Alaskan oil reserve; Outer Continental Shelf leasing; and questions about changes in the design of gasoline which will add substantially to crude oil demand with marginal possible impact on environmental progress. All of those, I think, have to be carefully thought through. But those are longer term things. I mentioned the shorter term things first.

Thank you.

[The statement follows:]

TESTIMONY OF CHARLES J. DIBONA

PRESIDENT, AMERICAN PETROLEUM INSTITUTE

I appreciate the opportunity to appear before you today to discuss the impact on U. S. oil markets of the Iraqi invasion of Kuwait.

My testimony today will cover three basic areas. First, I will review the recent behavior of crude oil and gasoline supply and demand, and their impact on market prices. Second, I will discuss the situation in the Middle East and what it could portend for the future. And third, I will cover possible policy choices and their impact on the future supply/demand situation.

Let me first quickly review the status of crude oil markets. As is well known, OPEC member countries were producing one to two million barrels per day more than consumers were utilizing over the first half of this year. Because of this, stock levels rose worldwide. At the same time, however, U.S. crude production dropped another 500,000 barrels per day relative to the same period of last year, bringing domestic production to levels not seen since the early 1960's. Despite this, the overall increase in world production put downward pressure on crude prices, until about two months ago when market participants began anticipating increased OPEC efforts to bring supplies into line with demand. This took spot crude prices from about $15.50 per barrel in mid-June to about $20 per barrel by the end of July, just prior to the Iraqi invasion of Kuwait. Since the invasion, crude oil spot prices increased by a further $8 per barrel as of the close of the spot market yesterday.

In the gasoline market, U.S. demand was relatively weak in the first half, though there has been some indication of renewed strength in recent weeks. U. S. refiners have been supplying this market at close to 100 percent of their effective capacity over the past several weeks, averaging 7.4 million barrels per day, and have been importing gasoline at very high levels as well. Indeed, U.S. gasoline production and imports have slightly out paced consumption in recent weeks but gasoline stocks remain low by historical standards.

Since the beginning of the crude oil price increase seven weeks ago, gasoline prices also have risen, though by less. In fact, from mid-June to August 3 crude oil spot prices rose by some 21 cents per gallon while spot gasoline prices rose by about 11 cents per gallon. Thus, refiners selling into the spot market have not fully recovered spot crude oil price increases over that period. One can find other comparisons, such as from the beginning of the year, during which spot gasoline prices have risen as much or more than spot crude prices. However, real downstream margins at year's beginning were the lowest they have been in at least twenty years, and so were unsustainable for any extended period. Today's margins, by contrast, are close to those of August 1988 and August 1989.

Recent events indicate that prices can move very quickly when world market conditions change. There are a number of reasons why prices may move more quickly than in the past. First, an increasing amount of trade has been occurring on spot markets. To a gasoline supplier buying on the spot market, costs of supply change with the spot price and hence are passed through almost instantaneously.

Second, the very existence of spot and futures markets in recent years has made price information more widely available. One result is that contract prices often are tied to spot prices, and hence are similar to spot purchases even though they are not counted as such.

Finally, much crude is now bought on terms in which prices are set by the spot market at the time of delivery in the U.S., not the price at the time of loading at their point of export.

Despite all this, average prices tend to move more slowly than spot as these are a combination of longer term contracts as well as shorter term and immediate transactions. For example, over the period July 17 to August 3, national average rack prices for seven of the largest companies increased by 3-5 cents per gallon even as spot gasoline prices increased by nearly twice this amount.

One criticism heard of petroleum prices is that they reflect future rather than past conditions. Thus, for example, refiners are criticized for increasing gasoline prices as supplies tighten relative to demand on grounds that conditions occurring when the crude was bought did not reflect such tightening. This reflects a naive and one-sided view of how markets work.

First, if any one refiner held prices down in the face of tightening supply/demand conditions while others - say those purchasing supplies on the spot market = raised their prices, that company quickly would be denuded of supply. In a competitive market, selling prices must reflect today's supply/demand conditions, including perceptions of what the future holds -- and anyone selling above or below that either will have too few customers, or too many. Second, this criticism fails to account for the reverse phenomenon, when selling prices suddenly fall. Last winter, for example, U. S. refiners aggressively sought home heating oil supplies in world markets during the very cold spell we experienced in December. These supplies were purchased at premium prices and were delivered in January, when the weather became extraordinarily warm and prices plummeted. So the oil companies who bought could not recover their costs, losing out on the risk they had taken in supplying previously increased consumer demand.

The behavior of prices during that instance is instructive. Many of the same criticisms of the petroleum industry were heard last winter as are being voiced today. But refiner prices both rose and then fell rapidly as supply/demand conditions changed, first for the worse and then for the better. Dispassionate analyses by the Department of Energy and others all concluded that industry behavior was completely consistent with what should be expected in a freely competitive market. I am confident that the same thing is happening now.

Let me now comment briefly on the prospective world oil supply situation and the possible effects of events occurring in the Middle East. An effectively enforced boycott of Iraqi and Kuwaiti oil would remove a little over four million barrels per day from world supplies for an indefinite period. This is a little under 8 percent of free world demand. Our best estimates are that this could be completely replaced -- if all exporters with excess capacity, including those in the Persian Gulf, increased production to their full potential. However, of this four million b/d excess, only one million or so lies outside the Gulf. So if Gulf producors are reluctant to increase output, we could experience a three million barrel per day shortfall.

The experiences of the 1970's give us an idea of what such a shortfall could mean. In 1973 we were initially confronted with a 4-1/2 million barrel per day reduction in supply, at a time when free world demand was not much different from what it is today. World prices soared to nearly four times previous levels, and the West experienced a painful economic recession lasting almost two years. In 1978 - 1979 the net shortfall was closer to 2 million barrels per day, with the U.S. experiencing about one third of the total. At that time the price about doubled and again we experienced an economic slowdown.

The impact of a reduction of 3 million barrels per day in world supply, with the U.S. absorbing perhaps one million barrels of that, would depend crucially upon how long it lasted and how we adjusted to the situation. First, the price increase which already has occurred will help to reduce demand, just as it did in the 1970's and 1980's. Second, private stocks of crude are currently ample and we have an asset we did not have in the 1970's -- a large government held strategic reserve. Given its present size, if we chose to utilize only one to two million barrels per day from this stockpile, we could sustain that rate for many months. If other countries similarly released stocks and if we did not panic or take clearly counterproductive steps, we could probably sustain the loss of Iraqi and Kuwaiti oil without serious damage for an extended period of time.

That brings me to my third point. In the 1970's the U.S. government responded to oil market shortfalls in the worst ways possible, by slapping on price and allocation controls and later a special excise tax on domestic crude oil production. The results were long gasoline lines created by the need to find some alternative way to ration supplies, reduced domestic production, increased domestic demand, and growing oil imports. This panicky reaction should be avoided by the federal government and by state governments at all costs. The facts give no reason for panic. Potentially constructive steps are available to the country.

In the short term, in addition to possible use of the SPR there are at least two steps which should be examined. The first would be the opening of the Point Arguello field off of California, which has been ready to begin production for about two years. Company estimates indicate this field could add some 80,000 barrels per day to domestic supply. Second, recent EPA regulations to reduce gasoline RVP have resulted in incremental crude demand estimated at 150,000 b/d while achieving only modest environmental gains. A temporary relaxation of this regulation during the boycott could effectively add to domestic supply.

In the longer term, we have many options on both the demand and supply side. To name just a few affecting our industry, the option of opening the coastal plain of the Arctic National Wildlife Refuge should be vigorously pursued, more of the Outer Continental Shelf should be made available including especially areas which already have been leased such as those off North Carolina, the use of tax incentives for domestic production should be supported, and environmental regulations such as those involving reformulated gasoline should be carefully weighed for their energy impact as well as their environmental implications.

In conclusion, while the Iraqi invasion of Kuwait has had a substantial impact on world oil markets, we are in a much better position to handle this than we were 10 years ago and there is no reason for panic. Furthermore, while there are only limited steps we can take in the short term to decrease our oil dependence, the events of the last two weeks should provide us with the incentive to take the longer term steps necessary -- including increased leasing of the Outer Continental Shelf and the opening of the Arctic National Wildlife Reserve -- that will ensure a more secure energy future.

Senator BRYAN. Thank you very much, Mr. DiBona.

The American public is angry. They are mad as hell, and there is a pervasive cynicism that in effect they are being held hostage to all of you, the oil companies, and I must say that every time there is an incident that occurs, such as the tragedy of the *Exxon Valdez*, oil prices rise sharply and immediately, and one could cite other instances.

Then, conversely, when these market forces occur in which the price of crude oil drops the reverse consequence does not occur. That is, the price to the American consumer does not go down.

So there are, I think, out there, some folks that are angry as hell, and frankly, I have to say that based upon the information we have available, their anger is justified.

Let me invite your attention to a chart that is posted there on the right.

The source of this is the Energy Information Administration, and it charts the first 7 months of the current year.

As you can see, on the bottom line it indicates the crude oil price dropping from what appears to be about 49 cents a gallon, hitting a low point in June of this year, and then the gasoline price which has gone up.

The difference indicates there is an excess refinery margin, or a consumer overcharge, representing the difference between the crude oil price and the price that is being charged the public.

Now, that information leads inescapably, it seems to me, to a conclusion that there is real corporate misconduct and abuse of the American public. Let me ask you, gentlemen, is the chart accurate? Is it not accurate? If not, how do we explain this?

Mr. DIBONA. Well, let me say that you have to look at a somewhat longer period of time. If you took this chart and advanced it on the left-hand side, or the right-hand side—but let us simply take the left-hand side for the moment.

That is, this shows the trends from January of this year to July. If you took from July of 1989 to December of 1989. you could flip this picture over to the left and it would show exactly the opposite. That is, between July of 1989 and December of 1989, crude prices increased 3 cents a gallon and gasoline prices fell 11 cents a gallon, and in fact in December and January——

Senator KERRY. Where did gasoline prices fall 11 cents a gallon?

Mr. DIBONA. These are retail prices. They fell from 84.3 cents a gallon in July of 1989 to 73.2 cents a gallon in December of 1989. And the crude rose from 43.2 cents a gallon in July of 1989 to 46.5 cents a gallon in December of 1989.

I might also say something else about this so-called downstream margin, which is what is being measured here by simply taking the price of crude and the price of gasoline, in terms of cents per gallon, and comparing them. On an inflation-adjusted basis, that margin in December/January was the lowest margin, at the starting point of that chart, that had existed in 20 years. This was an extremely small margin. People were not recovering their costs.

The average for a long period of time has not been a 20-cent margin between crude and gasoline prices, but rather that margin generally has exceeded 30 cents, not 20 cents. So this is the absolute low point over two decades, when adjusted for inflation, and was not sustainable.

Senator BRYAN. But it was certainly the low point from the American consumers' point of view.

Mr. DIBONA. This is just a very careful selection of figures.

Senator BRYAN. First of all, these charts were not prepared by this committee. They are from data of an agency of the Federal Government, which, in my own view, does not have a notable record of being aggressive on behalf of the consumer. So it is not an attempt to slant or distort. This is what they show us.

Mr. DIBONA. Well, Mr. Chairman, I am not arguing that these numbers are not correct. What I am saying is that it is a careful selection of the period to make a point which in fact is misleading because if you went back six months you would find that exactly the opposite happened. That crude prices rose, gasoline prices fell, and the margin decreased by 14 cents. And you have got about a 14-cent increase. At the end of that period it was back to the 20-year average.

Senator BRYAN. Let us pull up another chart now.

Mr. DIBONA. And if you now take it from mid-June, you would find that in fact the price of gasoline on the spot market has not kept up with the crude price increases.

Senator **Bryan**. Mr. DiBona and others, I invite your response, and then I will yield to Senator Kerry for some questions. But let us take the previous year, 1989. You have got the *Exxon Valdez* environmental disaster that occurs, and look at that run-up of the price there.

Mr. **DiBona**. Of course, the point I was making is, if you look from June on that chart, you see the falling gasoline price and the increase in crude price.

Senator **Bryan**. That is very, very modest. In fact, it is almost a flat increase when you look at it.

Mr. **DiBona**. But that is 14 cents, and this chart is spread out.

Senator **Bryan**. But the point I am seeking to make, Mr. DiBona, is that you have got the *Exxon Valdez* and then all of a sudden you see that sharp spike being driven up immediately. Now you are telling us that all of these things are long term, and yet we see these immediate consequences. And yet when it comes to a price reduction, we do not see the same kind of immediate reaction that drives prices down.

Clearly, that leads the public, and I must say that I share this conclusion, that there has been either some manipulation or profiteering on the part of the oil companies. It seems like it is heads you all win and tails the consumers lose. How do you account for that? That is an entire year that you have there before you. And then I will yield to Senator Kerry.

Mr. **DiBona**. First, I would make the point that at the beginning and end of that year, the margins on gasoline were at extraordinarily low levels. And they ended the year at the lowest level ever. Thus, by December of that year we had a 20-year low in the margin between gasoline prices and crude oil prices I think that answers your question completely.

In the middle of that year we had an average margin. Now as far as observing price rises and price falls, in December of last year we delivered 50 percent more heating oil up into the Northeast area. We did that through extraordinary measures, including imports and moving material by truck instead of by pipeline. That succeeded. The price did rise 40 cents a gallon.

And by January, when the weather warmed up, the price fell back to the level it had started at. And people were holding large stocks that were bought in the middle of that crisis in order to ensure supplies, not anticipating that it would be one of the warmest Januarys and Februarys recorded, and they had to sell them at less than they purchased them for. That is the way the market operates, and it operates on the upside and it operates on the downside.

Mr. **Tilton**. Senator Bryan, if I could offer one company's perspective.

Senator **Bryan**. Yes, let me hear your response, and then I will turn to Senator Kerry for questioning.

Mr. **Tilton**. I would be interested if you could tell me, sir, on the previous chart, is it in fact the EIA's view that that margin is a overcharge to the consumer, or was that added to the chart?

Senator **Bryan**. How the Department of Energy characterized it?

Mr. **Tilton**. As an overcharge to the consumer?

Senator **Bryan**. I do not know whether the Department characterized it. I certainly characterized it as such, and there have been some citizen groups, Mr. Tilton, that have.

Mr. **Tilton**. I see. The point that I would offer is that we have established, Mr. Chairman, that the psychology of a unique event like the *Exxon Valdez*, like the events of the past several days, and like the extraordinarily cold winter of 1989 and 1990, do in fact move product markets in this country. That is irrefutable.

I would take exception on the basis of my company's experience, though, to the point that the prices do not return to normalcy. They do come down, and they did in fact come down with respect to the home heating oil prices in February of last year, in which my company lost a considerable sum of money, as I suggested to Senator Lieberman we probably would, on the basis of acquiring product at a peak so that we could bring product to market and supply our customers.

We look at our margins in an aggregate basis over the period of 12 months for any one given year; 1989 was not an extraordinarily good year for the downstream oil business in the United States. We made a rate of return of 8.9 percent on total capital in the United States in that year. That is one company's perspective on last year's gasoline margins.

Senator **Bryan**. Senator Kerry, let me yield to you now for questions.

Senator **Kerry**. Thank you, Mr. Chairman. It is hard to pick where to begin here.

Regarding the profit indications, you talk about a hard year last year. It is my understanding that Chevron profits were up 60 percent over the same quarter last year. This is talking about now. Sun Oil, Marathon and National Oil posted record refinery profits. Mobil profits were up 24 percent. Exxon was up 11 percent. As a whole, industry experts estimated that refinery earnings of the major oil companies are up 59 percent over the second quarter of last year. So evidently this year is a pretty good year.

Based on the chart that the chairman has shown, the differential may explain some of that.

Mr. **Tilton**. I would suggest that it does.

Senator **Kerry**. Now if you carry this chart back for all of last year and all of the preceding year, in point of fact for at least the period of these two charts, two years preceding and half of this year, this is the highest spread we have ever had; correct?

Mr. **Tilton**. Yes.

Senator **Kerry**. There is certainly not the tracking of a downturn which was referred to in Mr. DiBona's testimony submitted to us that somehow the prices came down as the crude price went down. Is that accurate?

Let me show you your testimony, Mr. DiBona. I think you say at page 2, "The behavior of prices during that instance is instructing. Many of the same criticisms of the petroleum industry were heard last winter being voiced today. But refiner prices both rose and then fell rapidly as supply/demand conditions changed, first for the worse and then for the better."

There is not in fact that kind of indication of a correlation between the supply prices and then the demand. It only fell about 5 cents at the pump versus about a cutting in half of the cost of crude.

Mr. DiBona. Are you talking about the heating oil situation last winter?

Senator Kerry. Previously.

Mr. DiBona. Yes. Well, actually in the heating oil situation last winter, the price of heating oil rose by about 40 cents in the middle of that crisis when we had the coldest December on record in New England. Then in January when it started to warm and in February when we had extraordinarily warm weather, the price fell back 40 cents. I would be happy to show you that. So there was a sharp rise and a sharp fall, and those figures are clearly available.

Mr. Tilton. Senator, I believe your chart——

Senator Kerry. Those are gasoline?

Mr. Tilton. Yes. I believe your chart is for gasoline, so that would not be in sync with Mr. DiBona's testimony for heating oil.

Senator Kerry. I understand, and I do not want to belabor this because I have another series of questions I want to ask. It basically tracks with a variation, and the great low you cite in 1989 is in fact really not that far off the low of the year preceding. The fact is that there is a fairly smooth tracking with some fluctuations, and the greatest single fluctuation is in fact this year.

Mr. Tilton. It was low to the extent, Senator, that it reflected negative refinery margins which are a matter of reported record. If the price relationship continues as it is today, for example, crude to gasoline, crude having gone up 50 cents, gasoline having gone up significantly less, we will be looking at negative refiner margins again.

Mr. DiBona. That fluctuation is about the same fluctuation that occurred between May and June of last year and December of last year. It is exactly the opposite thing. You went from an inflation-adjusted spread of 34.6 to 21.2 and then up to 34.8.

So just as I said, if you take that picture and draw it like the one you have in your hand, you will see the same picture reversed. It is not true that the spread difference is bigger this year than it was last year.

Senator Kerry. Let me try to get away from the confusion of the charts and see if we can get this into layperson and simpler terms and try to understand really what is happening here.

You purchase oil from whatever foreign nation in a bulk amount. Is all of the oil that you purchase purchased for a payment price on arrival?

Mr. Tilton. The majority of ours is.

Senator Kerry. What percentage?

Mr. Tilton. I would say that it is all tied, Senator. All of the imported oil is largely tied, the vast majority of it is tied to a spot price at the time of delivery, to a spot quotation price at the time of delivery in either the U.S. Gulf or whatever refinery center it is destined for.

Senator Kerry. Is any of it purchased at a fixed price in the point of pickup?

Mr. Tilton. Very little.

Senator Kerry. What percentage? Give me an idea.

Mr. Tilton. Less than 5 percent.

Senator **Kerry**. How many barrels per day are we talking about that Texaco would purchase on the average?

Mr. **Tilton**. We have said that we purchase half of on the order of 2.5, 2.12 million barrels that we refine.

Senator **Kerry**. That you refine each day?

Mr. **Tilton**. Right.

Senator **Kerry**. Half of that is purchased?

Mr. **Tilton**. That we sell. So it includes product purchases as well.

Senator **Kerry**. I still want to try to be precise here.

So you are saying 2 million barrels refined?

Mr. **Tilton**. Our total sales in the United States.

Senator **Kerry**. How much of that is imported under the spot price conditions? How many barrels are day for Texaco?

Mr. **Tilton**. More than half.

Senator **Kerry**. More than 1 million barrels?

Mr. **Tilton**. That is right.

Senator **Kerry**. How much comes from Kuwait and from Iraq?

Mr. **Tilton**. A very small amount.

Senator **Kerry**. Give me a percentage of those barrels.

Mr. **Tilton**. Virtually none.

Senator **Kerry**. Virtually none.

Mr. **Tilton**. It is going to be difficult to get at, I think, what you are trying to establish if I could presuppose.

We have a joint venture relationship with Saudi Arabia established on the Gulf Coast and the East Coast of the United States. For that particular market, virtually all of the oil that is refined in the Port Arthur Refinery, in the Delaware City Refinery and in the Louisiana Refinery is Saudi oil. So that is on order, Senator, of 615,000 to 620,000 barrels of oil a day.

Senator **Kerry**. 620,000 barrels a day.

Now in point of fact, how much is delivered on any given day? It comes by tanker every day?

Mr. **Tilton**. Oh, yes, sir.

Senator **Kerry**. Every day?

Mr. **Tilton**. Sure.

Senator **Kerry**. How many tankers would be offloading?

Mr. **Tilton**. Senator, that is an extremely difficult question to answer because it comes in a pipeline that is about, as you know, 30 to 45 days out in time. I would suggest half a dozen.

Senator **Kerry**. Half a dozen tankers would be of floading.

Mr. **Tilton**. And lightering.

Senator **Kerry**. Right. In total for Texaco?

Mr. **Tilton**. For that particular segment of our market, that is right. Now just to clarify, in the midcontinent and in the western part of the United States, most of the crude oil that is refined in those refiners, of which there are four, is domestic crude. So it is midcontinent crude, it is Kansas crude, it is Alaska crude, it is California crude.

Senator **Kerry**. Which four refineries are these?

Mr. **Tilton**. Kansas, one in Bakersfield, one in Los Angeles and one in Puget Sound.

Senator **Kerry**. Those are your four principal supply sources of refined oil?

Mr. **Tilton**. West of the Mississippi.

Senator **Kerry**. And east?

Mr. **Tilton**. Delaware City, Louisiana plant in Convent, Louisiana, and Port Arthur, TX.

Senator **Kerry**. Seven in all?

Mr. **Tilton**. Yes, sir.

Senator **Kerry**. So we have seven in all, and you say west of the Mississippi none of that is foreign; is that correct?

Mr. **Tilton**. Very little.

Senator **Kerry**. So it is three refineries directly impacted by the foreign oil?

Mr. **Tilton**. That is correct.

Senator **Kerry**. Now those three refineries take how long to refine a load and put it out in the market? Is it about a 20-day average?

Mr. **Tilton**. That is a reasonable average.

Senator **Kerry**. Can you help explain to me, then, notwithstanding the spot price, what there is in the current supply structure of this country that requires the consumer two days after the Iraqi invasion to be paying an increased price for oil that has not yet been refined and put into the system?

Mr. **Tilton**. Senator, it is a situation not dissimilar from the one that we discussed in the heating oil crisis of last year. As I have said, a large portion of the total supply from just our company of over 2 million barrels is purchased product as well as refined crude oil from our 7 refineries. That purchased product I cannot, I suppose, allow us to say notwithstanding the 9.3 cent increase yesterday in the New York Mercantile Exchange. In essence, that sets the price of motor gasoline. It sets your replacement price, and it sets your reference price. Mr. Chisholm has said it eloquently.

Senator **Kerry**. But it has nothing to do with the cost to you of the product you are actually putting into the market?

Mr. **Tilton**. It does to the extent——

Senator **Kerry**. Only the replacement.

Mr. **Tilton**. Only the replacement; that is true, Senator, to the extent that it is not that discreet gallon of gasoline that is about to be delivered. Were I not to be mindful of that price—I am a marketing manager about to set the price for my product at my sales terminal, and, as Mr. Chisholm has said, I am a good oil company. I price that product irrespective or notwithstanding, as you suggest, of the 9.3 cent increase on the Mercantile Exchange yesterday.

All of Mr. Chisholm's constituent companies will come to my terminal to purchase my product because we are posting a price significantly below the market price. This one company with 7 percent of the motor gasoline sales in the United States cannot post a price into any market in the United States that it out of step with the realities of the market. We cannot post it too high, obviously, nor can we post it too low.

Senator **Kerry**. I understand we have a crude oil surplus which is higher today than we have had it at any time in 17 years. If your supply is adequate and you are truly competitive as an industry, why is that not an opportunity to sell at a lower price and get more market share?

Mr. **Tilton**. Our supplies would not be adequate, Senator, to continue to supply gasoline to all of our sales terminals were we to price below the market.

Senator **Kerry**. That would be because people would increase the demand for your product, would they not? You would sell more; correct?

Mr. **Tilton**. Certainly.

Mr. **DiBona**. You should understand something about the size of these stocks, though. This market is supplied from current production or imports, not significantly from stocks. The crude oil stocks are up 50 million barrels total over a low point that they were at earlier.

The point is that these comprise three days of United States consumption; three days. You do not count on those stocks to make a significant difference in the amount of oil available to the public. You are counting on production and imports to get the bulk of the supply to the market.

Senator **Kerry**. Do you know what you are really telling me? That we do not have a market and this is what the dealers said earlier, it is not competitive. It is not truly competitive. If it were truly competitive, you would put your product out there at a lower price and you would sell it. But as you say, you cannot continue to provide the supply because the demand would then be too high.

Mr. **Chisholm**. Senator, if I may address that point from my members' perspective. What Mr. Tilton is saying is correct. Attached to my testimony is the prices of four different suppliers at a terminal in Pennsylvania. That was supplied to me by a distributor who was supplied by all four of those suppliers. Now, every morning that supplier looks at the posted price of all of the different suppliers and chooses where they are going to buy the product, where they are going to go and buy the product.

Now, if Mr. Tilton's price is 9 cents a gallon below the competitive prices in that particular market, they are all going to flock to Mr. Tilton's refinery or Mr. Tilton's terminal. In addition to that they will not only try to buy enough supply for them, they will also take the product and broker it to other people. People who are more relying on a non-contract basis, on-the-spot-market, they will come to my members and want to buy on a broker basis. They say, you go into the Texaco terminal, you pull that cheap product and I will give you a certain percentage of profit on it, and you sell it back to me. The existence of the market would collapse if Mr. Tilton did price his product that much below.

I mean, my guy would love it. He would love to be able to go in the terminal and be able to have that advantage. But he would have the same problem on the street. If he bought it from Mr. Tilton and tried to sell it at 9 cents a gallon cheaper than any competitor on the street, he would have gasoline lines at his station. And he would have supply for about 10 to 15 days out of the month. He would have to close his station the rest of the time.

Senator **Kerry**. I have gone longer than my time; the red light is on. I just have one other question that I want to ask of you.

Do you participate in the spot market?

Mr. **Tilton**. Certainly we do. We buy our product in the spot market. Yes, sir.

Senator Kerry. And to what degree and how often is that?

Mr. Tilton. Daily.

Senator Kerry. On a daily basis you are participating in the spot market?

Mr. Tilton. Absolutely. Yes, sir.

Senator Kerry. Well, I think that raises its own set of questions. I will leave those, maybe, to Joe Lieberman.

Thank you, Mr. Chairman.

Senator Bryan. Thank you. Next is Senator Robb.

Senator Robb. Mr. Chairman, because I had to be absent, I missed part of the opening part of this particular portion of the testimony and I will pass temporarily.

I may not be able to remain for a full round of questioning.

If the participants could make available some pricing information to various markets in terms of the last week or so, it would be very useful to me in simply getting a factual grasp on the situation. I understand that there are a number of allegations that always point in some other direction other than the particular panel or group before us with respect to the reason for some of the price increases. And it would be very useful if we could get that kind of information.

I realize that in a couple of instances, it would be generic or general. But, Mr. Tilton, perhaps for your company, if you could let us know what the prices were to a specific market over a 5 to 6 day period so that we could get some sense of how the prices have actually fluctuated with respect to those who depend upon you for their supply of petroleum product, I would be very much appreciative.

Mr. Tilton. We would be glad to do that.

[The following information was subsequently received for the record:]

James C Pruitt

Corporate Communications

August 9, 1990

Honorable Charles S. Robb
United States Senate
Washington, D.C. 20510

Dear Senator Robb:

Mr. Glenn F. Tilton, President, Texaco Refining and Marketing Inc., appeared before the Senate Commerce Subcommittee on the Consumer on August 7, 1990 and gave testimony on gasoline price movements which occurred since the Iraqi invasion of Kuwait. This letter is in response to your request for prices in a particular market over a 5 or 6 day period.

In regard to the above, I am attaching a summary of both Texaco motor gasoline movements and industry price movements for the period. In addition, we have included Texaco prices in the State of Virginia.

We trust that this information will be helpful to you in understanding the current price and supply situation. We are prepared to meet with you and your staff if you have any questions.

Sincerely,

James C. Pruitt

MG:gk
cc: Honorable Richard H. Bryan
Honorable John F. Kerry
Honorable Joseph Lieberman

INDUSTRY
Spot Prices USGC - $/Bbl

	6/1/90	7/2/90	8/1/90	8/2/90	8/3/90	8/6/90
ANS	14.70	14.26	19.68	21.90	22.94	27.74
WTI	17.22	16.65	21.65	23.35	23.86	28.29
MOGAS	28.35	24.26	26.36	28.14	30.77	34.97
DIST	19.74	19.22	23.84	25.31	26.04	30.24
RESID	9.75	9.50	12.25	14.00	14.00	16.00

TEXACO PRICES
State of Virginia and Baltimore, Maryland
Effective 8/8/90

Terminal	Retailer Price		Wholesale Marketer Price	
	8/1/90	8/8/90	8/1/90	8/8/90
Fairfax	.7590	.8600	.6880	.8400
Richmond	.7200	.8275	.6650	.8375
Norfolk	.7225	.8300	.6650	.8375
Roanoke	.7075	.8150	.6650	[illegible]
Baltimore	.7420	.8400	.6880	.8400

- Retailer Price is Texaco's price to Retailer. Retailer adds his mark-up (margin) + taxes. This total would be street price.

- Wholesale Marketer Price wholesaler adds his mark-up (margin) then resells to his retailer customers.

Senator **Bryan**. Thank you very much, Senator Robb.

Senator Lieberman.

Senator **Lieberman**. Thank you very much, Mr. Chairman.

Gentlemen, as you know this is the third time in 18 months, as I believe you said, Mr. Chisholm, in which the country has been upset about a price spike in gasoline and oil. But I must say to you—and I am not sure that your testimony today indicates that you appreciate that—but in my opinion, something very different has happened on this occasion. It harkens back to the first experiences of an assertive OPEC that we had during the 1970's. But today we have a nightmare that goes well beyond what we found in the 1970's. In OPEC we had, after all, some moderate Arab states—some other states that were our allies—with which our companies had cooperative relationships.

Today, we have in Saddam Hussein a declared enemy of the United States. He, in my opinion, is, I do not even want to say a madman, he is a calculating, vicious dictator and he has shown repeatedly that he is prepared to use whatever resources he had to achieve his ends. We now have a situation where he controls 20 percent, I believe, of the world's oil reserves. He may also be in a position, whether he invades Saudi Arabia or not, by fear, to intimidate the Saudis and control over 40 percent of the world's oil reserves.

I do not think that in that circumstance we can have business as usual. We are in a position now where one man, who is our enemy, can affect not only our economic security as a country, but our very independence because we depend on oil. The business that you are in, is still the economic lifeblood of America. This country will not run without it.

That is why before you came many of us suggested our own hope, frankly, that the President would call you in, call in the representatives of the industry as President Kennedy did with the steel industry and appeal to your sense of national purpose, your patriotism to work together with Government. Not to make a bad situation that Saddam Hussein has created worse.

I regret to say that I think the American people for one, feel that we are not pulling together on this one.

We have got to figure out a way to make this work because our national security is on the line here. I must say that in hearing some of the things you said, I still cannot—maybe I am dense, but I cannot get it in my head that last Wednesday before the invasion of Kuwait, you were refining gasoline out of crude oil that you had purchased at a given price. I presume that today you are refining gasoline out of crude oil that you purchased at that same lower price. You clearly bought it before the invasion of Kuwait. I mean, the Financial Times last week said that the industrialized nations have a 5 month supply of crude oil.

So, how can we understand that you have to bid up the price in the way that you do because of the panic on the market, and that if you did what seems to be reasonable and fair—which is to sell at a price related to your original cost, still allowing you a profit—you are going to get bought out of your supply.

Just as Senator Kerry said, to me what you are acknowledging here is that there is not real competition in the market. And maybe there are grounds for an antitrust action. I think we need better answers than what we have gotten so far about how the price you are charging people could have gone up while you are using crude that was bought at a lower price.

Mr. DiBona. There are two levels of answer to your question. One of them deals with the question about the national security of this country and the energy security and economic security of the country. It is true that we cannot have business as usual, but business as usual for the Congress has meant a number of steps which have discouraged domestic production of oil. And therefore, we have increased our dependence on foreign supplies.

One of them is the decision to use the appropriations process to prevent drilling on the outer continental shelf.

Senator Lieberman. Mr. DiBona, respectfully, I am going to accept what you are saying as valid for now.

Mr. DiBona. It is something that we have been saying for a long time.

Senator Lieberman. There is a lot blame to be passed around in terms of our reliance on foreign oil. But you have these basic questions that the supplies of crude oil are high, you bought that supply at a lower price and yet, in the last week, you have run up the price. And everybody along the line has run it up; it is not just yourselves.

Mr. DiBona. Well, these markets work in two directions. There is no question about that. The stocks that you talk about are not large relative to the daily worldwide consumption. Worldwide consumption in the Western world is around 54 million barrels a day. The stocks are not large compared to that. The amount we are losing is about 4 million barrels a day if this embargo is truly successful.

If 1 million can be produced outside of the area, then the net loss is 3 million barrels a day; that is about 6 percent of the world's supply. It is in between the level we lost in 1973 and the level we lost in 1979. It is a substantial and large impact.

Senator Lieberman. Do you take issue with the numbers in the Financial Times that there is a 5 month supply of crude oil in the industrialized nations?

Mr. DiBona. What they must mean is that there is a 5 month supply to make up the lost increment, not a 5 month supply of total consumption.

Senator Lieberman. To make up what increment?

Mr. DiBona. To make up the 3 million barrel per day shortfall, which is 6 percent. There may be 5 months to cover a 6 percent shortfall, but not 5 months to cover a 100 percent shortfall.

Senator Lieberman. I will check that out. I thought that they were saying otherwise about the supply.

Mr. DiBona. Well, just take the United States figures. We have two-thirds of the strategic petroleum stocks in the world. We have 590 million barrels. If that stock were trying to cover the whole world that would be 11 days. So the reference obviously must mean 5 months worth of stocks to cover the lost increment. The rest of the world has some 300 million. In total, that is about 1 billion barrels; 1 billion barrels is 20 days of the free world's supply.

Our stocks of crude in the United States are 380 million barrels. All of that above 300 million barrels has to be in the system or it does not work. That is, a pipeline only has flows if it is full of oil, not if there is just 1 barrel moving through it. So we really have something like 80 million barrels maybe that we could draw down. And that is just a few days worth of consumption.

Senator LIEBERMAN. But we are not in the position we were in last winter when there were low inventories and you were obviously scrambling to meet. the market demand because of the drop in the temperature. You are not scrambling now.

Mr. DIBONA. Your perception is that huge amounts of oil equal to all of United States consumption somehow could be drawn down before you had to buy the next barrel. But you have got to buy the next barrel now because very little can actually be drawn down. We depend primarily upon current production and current imports, and we have very little real stock drawndown capability. This is so even though the stocks are high, through not the highest in 20 years—I think 1983 was the highest level since today in crude stocks. The stocks that can be drawn down are more normal right now, maybe 80 million barrels. That is less than 5 days.

That is just a few days in crude stocks, so if we are not immediately replacing these stocks, very shortly you will not have oil.

Senator LIEBERMAN. Then the question that you come to is why are you charging your wholesalers, or customers, the price on the market today if you still have some old, if I can call it older, oil in the pipeline?

Mr. DIBONA. You are replacing it today.

Mr. TILTON. Senator, we went through this exact same conversation, you will recall, on January 16. And Mr. Chisholm says it quite eloquently, the price of motor gasoline in the United States today in any particular market, whether it is the New York Harbor, whether it is the U.S. Gulf Coast, whether it is Los Angeles, is set by the spot value that is published in a variety of different periodicals on that particular day.

If you price your product significantly differently from that price, you have either given a reseller, a distributor, a wholesaler, a significant competitive advantage, or you have given him a competitive disadvantage if you have priced it above that product and he has alternative sources below it.

I think one thing that would help understanding, and I would make this an assertion for your consideration, is that the product markets in the United States today are not moving in tandem with the crude markets as they used to. And I would ask you to think about that. I think that your chart, with all due respect, Senator Bryan, is just about to be declared obsolete as we move through an era of reformulated gasoline, as we see significant dislocations caused by differences from region to region on RVP specs.

The gasoline market is beginning to move to its own rhythm, separate and distinct from the movements of crude oil pricing in the United States, and for that matter, in the world oil markets.

Senator Lieberman, the other thing I would ask you to consider is the extent to which product imports play an immediate role in the price of motor gasoline in the United States today, over which no refiner has any influence.

Senator **Lieberman**. The red light is on, but, Chairman, if I may have just one more question to follow up.

If all this is true, then why does not it work in reverse? In other words, if the increase in the world price, because of expectations, because you are, planning to buy the coming supply of crude oil bids up the price? Why does not it work the other way when the world price drops, why does not the price go down?

Mr. **Tilton**. Senator, we lost just about as much money as I suggested to you we probably would in February of last year on the basis of having priced heating oil stocks so that we could supply Mr. Chisholm's constituents, and so they could keep people warn. We lost a tremendous sum of money when the value of those stocks dropped precipitously immediately thereafter when the weather warmed.

Senator **Lieberman**. Well, my time is up.

Mr. **Chisholm**. Senator Lieberman, if I may address a couple of points.

Senator **Kerry**. May I just ask, are you saying, then that you made up the difference by dragging out the reduction in price, that that is essentially what you did?

Mr. **Tilton**. No, sir, they are completely different markets, Senator Kerry. The heating oil market, for all practical purposes, was over in the month in which we lost the money.

Senator **Kerry**. I think the Senator is asking why the gasoline market price does not drop.

Senator **Lieberman**. Exactly.

Mr. **Tilton**. As I think we were trying to say, during 1989, Senator Kerry, it did in fact fall immediately after the spike in 1989 with the Valdez psychology. And it declined precipitously from that point forward with the EIA's own numbers.

Senator **Lieberman**. But it clearly did not decline at the same time that the world price declined.

Mr. **Tilton**. I would go back, Senator Lieberman, and tell you that the gasoline market will move to supply/demand realities, in the United States, to the availability of refining capacity, to the number of refineries that are up and running at any given time. And that will set it apart from the rhythm that you would expect it to track crude oil markets as if it is going to forever track those markets discreetly.

Senator **Lieberman**. That is somewhat in your control, is it not, because, after all, you are refining?

Mr. **DiBona**. No, the gasoline is being designed by EPA, and it is a dif ferent gasoline this year than it was last year. We have had to reduce the Reid Vapor Pressure of gasoline, and that one decision alone has meant that it takes 150,000 barrels per day more crude oil to make the same volume of gasoline. And that costs more money. It also takes a lot more refinery processing.

Senator **Kerry**. But you guys are choosing to push premium over regular unleaded, and it would cost you a lot less if you pushed the unleaded, because many of the cars in this country do not need it. That is a marketing decision.

Mr. **Tilton**. What would lead you, Senator, to believe that we are choosing to push one over the other?

Senator KERRY. Well, it is a matter of reality. A lot of cars in this country do not need it. They could run on the regular unleaded, and that is not what the consumer is led to believe. And premium is more costly and premium is being produced more.

Mr. TILTON. Speaking, Senator, only for one company, the growth in gasoline sales in our business is in the mid-grade 89 product. It is not in premium unleaded.

Senator KERRY. Well, I do not think that is true of the other companies.

Senator BRYAN. Let me follow up, Mr. DiBona. You are indicating that some of the requirements, in terms of reformulation, is a compounding part of this complex scenario?

Mr. DIBONA. For the future, yes.

Senator BRYAN. In looking at your prepared testimony, I suppose those who would be critics of the oil industry would point out—you say that there is really no reason to panic. Well, certainly, there is a winter ahead. There are some concerns in terms of the implications for the economy with this rapid run-up in price. We have had testimony this morning from the trucking industry which indicates what they are going to be doing and the costs they are going to be passing along. We all are dealing in an economy today that is extremely fragile. And some parts of the country have slipped into a recession.

But you suggest a series of things—if we could open up the field off Point Arguello, if there were a temporary relaxation of certain environmental requirements, if the environmental regulations such as those involving reformulated gasoline. Now I would say to you, respectfully, Mr. DiBona, that your critics would say, are not you guys really trying to shove it to the American consumer as an attempt to get relief from some of the environmental controls that you object to.

Mr. DIBONA. Well, if you fully read my testimony you would find in the preceding paragraph that I talk about the fact that we have 590 million barrels of oil in the Strategic Petroleum Reserve. We strongly advocated the construction of that reserve——

Senator BRYAN. Well, I do not think- there is disagreement among the panel.

Mr. DIBONA. And if the numbers I cited earlier are correct, that is, there is a 3 million barrel per day world shortfall as a result of a successful boycott, than in the past, in the last two crises, we took about a third of the shortfall, which this time would equal about a million barrels a day. In that case, you could release oil from the Strategic Petroleum Reserve. The Government has that authority. That could make up the shortfall. However, similar steps would have to be taken in other parts of the world, because otherwise you could still have a crude price rise, since oil is an international market, not a national market.

Those kinds of steps can be taken. Also, these price increases will have an effect on consumption. And there are the other steps that I mentioned. So there are a host of steps. And quite frankly, in the long run, this country has to look at the question of whether we should continue to increase our dependence on a place like the Middle East.

I am sorry that it bothers you that I raise that, but I think it is an important thing for you to consider.

Senator **Bryan**. But, as I say, it seems to me that in a sense you are trying to have it both ways. Let me get back to the Department of Energy news release of August 2nd. And what I hear you saying, Mr. DiBona, seems to be at variance with what the Department of Energy is sharing with me. Let me read the statement, and tell me if you agree or disagree with it.

"The Department of Energy in their press release last week said, 'Uncertainties in the Middle East pose no,' and this is their language, 'immediate threat to the supply of petroleum products for American consumers, nor do they necessitate increases in prices for American consumers.' "

As I read that, as a layman, there is no immediate, short-term, I would concede that to be, threat to the supply of petroleum products. Nor any basis upon which prices should increase.

Mr. **DiBona**. I do not know when that statement was made.

Senator **Bryan**. Well, it was made August 2nd. And again, this is not something I have conjured up. This is their statement. You can appreciate, in light of what you and others here are saying on the panel this morning, that seems to be at marked variance with what the Department of Energy is saying.

Mr. **DiBona**. I do not know their basis for making such a statement. What I have given you are the facts. I do not know if they had urged a worldwide boycott as of that date, because I think August 2nd was the day of the attack. And to the extent that a boycott is imposed or threatened or apparently working at the moment from the shutdown of one of the oil pipelines across Turkey, and the reduced volumes through it, if those things are happening, it is going to have an impact on oil markets. And I would respectfully question the accuracy of such a claim.

Senator **Bryan**. So you disagree then? Let me try to get this down in the idiom of the street. You would disagree, then, with the Department of Energy?

Mr. **DiBona**. I would certainly disagree that the loss of 3 million barrels a day would have no impact on markets. I do not see how one could say that.

Mr. **Tilton**. If I could, Senator.

Senator **Bryan**. Yes, Mr. Tilton.

Mr. **Tilton**. It seems something at odds with their own statement of yesterday which said the domestic and international markets are reacting as one would expect to uncertainty about future petroleum supplies.

Senator **Bryan**. Well, they are talking, of course, about the future. I think all of us would recognize that the long-term implications of the situation in the Middle East continue, and are something that would visit some economic consequences, in terms of the price of oil. But we are talking about the short term.

Mr. **DiBona**. Well, this is a statement in the present, "are reacting," and not a future statement.

Senator **Bryan**. Well, let me return to the line of questioning that I think Senator Kerry was so carefully developing, and which I think you were responding to, Mr. Tilton.

Mr. **Tilton**. Yes, sir.

Senator BRYAN. He developed as a premise or a thesis, if you will, that there is a lag time between even that tanker off-loading and the price you pay today in terms of the price of the product that is being refined and on the market the same day. That, in a market in which prices are rising, clearly that which is being refined and sold that day costs the company less than the price of the crude that is off-loading that same day.

And I think you would agree with that, would you not, sir, in a rising market such as we are experiencing?

Mr. TILTON. That is a reasonable assumption.

Senator BRYAN. And I think the question then that he asked you was, if you sold it at a price that allowed you a reasonable profit based upon the cost that you paid for it, you indicated that there would be a run on the product, or words to that effect, that you would run out of the supply because people would race in and buy. Did I understand your testimony correctly?

Mr. TILTON. Senator, I was affirming what Mr. Chisholm said. Which was that he quoted the prices in a Pennsylvania market for four separate suppliers. And he established in the context of a distributor, a reseller, a wholesaler, that has access to all four sources of supply, were one of them significantly different than the other, they would obviously pull product from that terminal disproportionately as relates to the other three.

So if we were to try to price our product in a market, irrespective of what the reference price, the spot value, the New York Mercantile Exchange, established as its value on any given morning, we would be out of step with the realities of the gasoline market. The point that I would simply like to pursue is the DOE on August 2nd was incapable, despite the best of intentions, to influence the course of price movement on the New York Mercantile Exchange in subsequent days.

We saw it go up on the 6th by 9.3 cents despite the fact that the DOE wished that it would not. Neither the DOE nor Texaco can influence the price on the basis of wanting to price at a fair price. Let us take the case of a marketing manager that wakes up in the morning and finds that the price on the New York Mercantile Exchange has gone up 9.3 cents. He does not want to price the product into the market at that price.

Senator BRYAN. What do you tell him to do, sir?

Mr. TILTON. He has to price our product if we are to make it available to all of our retailers to sell to all of you at a reasonable price consistent with the average aggregate price in the marketplace so that we are not below the market.

Senator BRYAN. But with all due respect, your answer suggests that there is a course of corporate conduct throughout the oil industry that responds to that pressure.

Mr. TILTON. What it suggests is that major gasoline markets in the United States are intensely competitive, both up and down.

If you price your product significantly out of step with those competitive markets you create a dislocation for yourself. I do not think, in due respect, that it would be significantly different for milk, or any other product that we buy that is perceived by the consumer as a commodity.

Senator **Bryan**. I understand. I do not agree, but I understand what you are saying.

But, as I understand the marketing strategy or practice in other industries, it is, if you have got a product, whatever it is, that ultimately winds up in the stream of commerce, it is priced based upon the cost of the component parts of that product that day, not based upon future increases of cost that you may have as a result of negotiating a different labor contract, or an increase in the cost of materials.

If the industry generally, not Texaco in particular, if its marketing strategy reflected that reality rather than the practice that you are telling us that exists, it seems to me the same market forces would operate that would suggest that there be a correlation between the actual cost of a product and its price.

Mr. **Tilton**. There are two points that I would offer for consideration, and then I will let Mr. DiBona amplify.

Number 1, I go back to the point that I wanted to make with Senator Lieberman. There is a significant amount of our total product consumption in this country that is supplied by imported product over which neither Mr. DiBona nor I nor any refiner in the United States has any control. You can make a case that that barrel sets the price in any given market that is susceptible to imported product. That barrel sets the price.

You have to also contemplate, as I think we have by looking at our margins over 3 years, that we are a business that has to look at our margins in aggregate, not in a snapshot or very short period of time, but over a long period of time, to arrive at a reasonable margin calculation.

Imagine, if you will, that you have a refinery manager today contemplating the prospect that the next barrel of oil that you offload, as Senator Kerry suggests, is a $28 barrel.

Indeed, probably as we speak, if the U.S. markets are reacting as the Singapore market suggested they would this morning, it is now a $29.50 barrel of oil. You cannot capture it. Would you then suggest that we should go out and raise the price immediately, as soon as that barrel is input into our refinery at that level? Is that what you would suggest?

Senator **Bryan**. Certainly there would appear to be some logic economically, based upon that in terms of what your cost was and what a reasonable margin of profit would be.

Mr. **Tilton**. With respect, Senator, the market would not bear it.

Senator **Bryan**. Well then, I would presume that you are overpricing your product.

Let me yield to Senator Kerry.

Mr. **DiBona**. I might just add a little to that response. One is that people have trouble understanding these market operations with regard to oil. They have no trouble understanding them with regard to grain, yet what we are describing here is identical to what happens to grain prices.

When grain prices move on the mercantile exchange, it is because supply/demand conditions have changed. Storms, or other similar phenomena occur, and produce costs do not change but grain prices do, and supplies are immediately marked to those prices. So what you are observing here is the market in operation just as it operates in grain.

The second point is that what evidence there is indicates that the oil companies are, in fact, exercising restraint. That is, their prices are not moving as quickly as the prices on the Merc.

For example, the AAA reported gasoline prices at retail. API itself does not collect any prices, because of antitrust law restrictions.

But according to AAA, the average retail price went up 11 cents since the beginning of this problem. The crude spot price went up 19 cents a gallon, gasoline spot prices went up 19 cents a gallon, and major refiner rack gasoline prices went up an average of 7.5 cents a gallon.

So what evidence there is suggests that there has not been a full passthrough of the increased costs. There is obvious restraint being exercised, restraint limited by the fact that if you get too far out of line you would have your tanks empty.

Senator BRYAN. Thank you.

Senator Kerry?

Senator KERRY. Thank you, Mr. Chairman. I do not want to drag this on too much longer. I meant to ask this earlier. I asked you about participation in the spot market. I was focused on the spot market, and what I had meant to ask you was whether or not you participate in the futures market. Obviously you participate in the spot market. Do you participate in futures?

Mr. TILTON. We participate in both.

Senator KERRY. In both. Well, is there any danger with respect to the futures market that if you are basically betting on a future price, do you not have a means of both influencing the outcome as well as an interest in it?

Mr. TILTON. Senator, respectfully, as a significant net purchaser of both crude and product in the United States, I would benefit from a lower price, not from a higher price, as a net buyer.

Senator KERRY. Well, it depends on how you are buying, does it not?

Mr. TILTON. Well, I am always going to want to buy at a price that is going to afford me a margin. If I had bought forward and that price runs up, I am going to find myself not unlike the refiner that is facing the prospect of current delivery at $28.05.

Now, if I have a contract that affords me the opportunity to buy product at a lower price, then I have that right, but you can see that there is really no benefit for me for that price to have run up beyond that contract price.

Senator KERRY. With respect to the earlier line of questioning——

Mr. TILTON. If I could, Senator Kerry, say just one other thing. I think any one company's participation on the Mercantile Exchange is such that it is not sufficiently significant for any one company to move its direction.

Senator KERRY. Okay. To what degree do you believe the price rise that has occurred is going to have a negative impact on the economy?

Mr. **Tilton**. I suppose, Senator, my guarded response would be that to the extent it is sustained it would have a deleterious effect on our economy.

Senator **Kerry**. To what degree do you think that this is viewed as a national crisis of some kind?

Mr. **Tilton**. It is my genuine feeling this morning, Senator, that it is viewed as a national crisis.

Senator **Kerry**. To what degree do you think it would be beneficial to the country if the oil companies were able to hold the line on prices now?

Mr. **Tilton**. I think, Senator, Senator DiBona—oops, I have elected him.

Senator **Kerry**. Have no fear of that.

Mr. **Tilton**. He would certainly have to choose a unique constituency. Suffice it to say that I think that the oil companies have held the line, and I think that Mr. DiBona's price information reflects that. We have gone up fractionally compared to what we could arguably say this morning the market would permit us to do.

To use Senator Lieberman's phrase on January 16, that might strain credulity but it also has the added benefit of being the truth.

Senator **Kerry**. It is, I suppose, a reflection either of the life pursuit that we are all engaged in, and maybe it is one of the reasons why we are in it versus you, but I continue to have difficulty understanding why, given the imperatives that we have just articulated—national crisis, deleterious effect on the economy and so forth—why there is such an immediate reaction to what is essentially a totally speculative market.

Mr. **Tilton**. Senator, let us take it back to Senator Bryan's vernacular of the street. Again, that is the price today, as Mr. Chisholm has established.

Senator **Kerry**. But it is the price today for something that is not being purchased by the consumer. It is the price today for a raw product which you are going to work on for some 20 days.

Mr. **Tilton**. No, sir, I was talking about the price of motor gasoline today on the New York Mercantile Exchange, not the price of crude oil. You see, again, we have to be cognizant of both. That imported barrel that is yet to find a customer, let us say in the Persian Gulf or the New York Harbor——

Senator **Kerry**. I understand, and that is what I want to pick up on. Why is it not possible, given the reality—and maybe you can help us here. This may really break a log-jam of understanding, conceivably.

Why is it not possible for the President to gather the troops, the principal oil companies together, and say to the Nation, because this product is not yet out in the market, and because this is not an accurate reflection of the cost to the consumer or to the company, and because we want to see how this is going to work out over the next few days—whether we can find supply from other areas and not really ever have a true interruption in supply so as to affect the market, we are asking them, and they have consented, to hold the price.

Now, if that announcement were made, would that not have an enormous impact on the marketplace, on the hysteria that is kind of driving prices up? I mean, I suspect that when you guys raise prices you are giving, you know, a rationale for the market to react the way it is.

Mr. TILTON. Senator, with respect, the DOE in its release of August 6 did precisely that.

Senator KERRY. But it did it on its own. It did not do it with you folks agreeing, 2 days after the crisis breaks.

Mr. TILTON. The point that I would like to just sort of close the loop on so maybe we can have a breakthrough is this: the DOE does not have the influence to affect the oil markets in the United States any longer, because the monolith of the oil companies controlling that price is no longer true. We do not set the reference price, Senator.

Mr. CHISHOLM. If I may follow up on that as well, it would not only be gathering the 16 or 18 companies, it would be gathering my 10,000 people, it would be gathering the 50,000 or 60,000 service station dealers, and saying that if they do not raise the price to you, you do not raise the price to your customer and they do not raise the price to the consumer.

Senator KERRY. Well, let me suggest to you that they are the ones complaining about the price they have to pay.

It seems to me in the so-called food chain here you have to start at the top, at least.

Mr. CHISHOLM. But my point is, if the reference price, the spot price and the reference price for imported product, or the New York Mercantile price is up here [indicating] and whatever the President may dictate or may want the other companies to do, the reference price would be the controlling factor, not what the President wants everyone else to do:

Senator KERRY. What is that reference price for gasoline itself pegged to?

Mr. CHISHOLM. Whatever the speculation is the market will bear on whatever day in question.

Senator KERRY. What is setting the price? What comes first, the chicken or the egg? Are you guys saying, we are going to raise the price, so that it follows, or do they set the price automatically?

Mr. CHISHOLM. [Nods negatively.]

Mr. TILTON. There has been no statement from any company that I am familiar with that we are going to "raise the price."

Let us go back to the situation, Senator, that I described, where a marketing manager wakes up——

Senator KERRY. Well, what happens? Does he wake up in the morning and look at the price and say, okay, this is what we are going to have to make the price?

Mr. TILTON. You look at virtually every signal the marketplace gives you, and you start probably with the electronic market, and that is the spot market and the Mercantile Exchange. That shows you what the reference price is up or down in any particular market across the United States.

The important thing to keep in mind is the first people to look at that, Senator, are your customers, your customers with their own rolling stock and their own discretion. Mr. Chisholm's constituents, they look at that price, they make a buying decision at that moment, at that day, on the basis of any one company's price relative to that price.

Mr. **DiBona**. There are two or three things that I would like to make a comment about, Senator. The first is that the President of the United States could not do what you were saying. I understand the principle you-are getting at, but as a technical matter he could not bring in the oil companies and get them to agree to hold the price, because they would be in violation of the antitrust laws if they did that. The Justice Department is very strict about that, so they could not collectively decide to either raise it, lower it or do anything else. They cannot agree. They cannot collude on the price.

Senator **Lieberman**. We will give you an exemption in this case, Mr. DiBona.

Mr. **DiBona**. Well, the last time we went through this we had such a meeting with DOE. Jim Schlesinger was Secretary, and the Justice Department came over and said, we are sitting here to observe this, but if any of you responds to his question regarding prices you should understand that we will prosecute you.

They said it more eloquently than that. But that was the thrust of it.

Senator **Kerry**. It must have been an administration that did not want-it to happen.

Mr. **DiBona**. Yes, that was the Carter Administration at that time. What they then did was to take each company and have a DOE officer sit down separately with it and discuss what kinds of things could be done.

What you really have to do is increase supply or reduce demand. Or you have to take steps to reduce the fear. And the worst thing you can have is to have people panic now. Because that will cause markets to rise.

The second matter is that——

Senator **Kerry**. You do not think that there is any of that happening now?

Mr. **DiBona**. I think that there is. I have just come from another hearing where there was testimony that computer models suggest that the market clearing price is $40, which would suggest that it has not happened yet. My guess is that there is some nervousness in the market and it is being reflected. And it is important to do things to try and ensure supply, not cause people to rush out and buy up all the gasoline in the stations and cause a run on gasoline. Because such things will have a tendency to tip the markets up. And that would not be a good thing for the country. The market has to clear and it will clear at whatever the supply/demand relationship in the long term is. I think the key thing that was missed in your conversation here was what is going on in the Mercantile Exchange. What happens in the Merc is there are hundreds of buyers and sellers. All of the sellers are trying to figure out how much the price is going to go up and only want to sell at the point where it peaks.

And all of the buyers want to find the cheapest price. They want to get it at the lowest price. And so they are trying to predict what the low point is. And at some point a transaction occurs, and that is the best indication of the market from the people most knowledgeable about future supply/demand situations, and who have made decisions which have a big monetary impact on them.

And that is why the Merc is the key to this thing. Because it is a true market. People are unconstrained in whether or not they buy or sell. It is comprised of willing sellers and buyers in a free market. And that is very central to this whole system. That is the same thing that happens in a grain market.

Senator **Kerry**. Thank you, Mr. Chairman.

Senator **Bryan**. Thank you very much, Senator Kerry.

Senator Lieberman.

Senator **Lieberman**. Mr. Chairman, just a few final questions. Obviously we are having something of a communications problem here. But Mr. Chisholm, I think we have let you off easy. So I want to come in on something that you said which strains credulity, as Mr. Tilton reminded me I said on one earlier occasion.

On page 4 of your testimony you talk about the perception since last Thursday when the invasion occurred that the price of oil will be going up. And then you say that this led consumers to increase their purchases of petroleum products to avoid future retail price increases, and that increases in demand rippled throughout the entire system and caused every segment of the petroleum industry to react the way any industry reacts when demand increases, which is to say prices are raised.

To me, that really sounds like you are alleging that the tail is wagging the dog. And not that the dog is wagging the tail. I mean, are you really contending that this problem has been caused in the last week because consumers rushed out to top off their gas tanks?

I have not seen any indication of it in Connecticut or anywhere else we have surveyed. In other words, there are not long lines, we have not seen what we would expect to see if consumers greatly increased demand, but instead, and we can argue whether or not it was fair or not, what happened is that people in the business reacted and raised prices.

Mr. **Chisholm**. I do not think there are lines, but I do think there has been a consumer reaction as people have tried to beat the next price increase, as I said, at both the retail service station level, and also we had reports from heating oil dealers about people wanting to fill their tanks up now because they are afraid in September or October the price will be even higher.

My point—and I will just cite one anecdotal story to back that up—I was on a radio talk show yesterday morning. And I made the same point—the consumer should not panic, there should be no rush to the gasoline stations, and that would fuel the increased demand which would raise prices even higher.

I made that presentation and my wife said immediately after I was done, my mother-in-law said, "Gee, I have got to rush out and buy a tank of gasoline before the lines start." And she apparently did not comprehend what I was trying to say.

But my point, on a very basic level, is that type of consumer reaction, afraid of what the next price increase is, is something that retailers feel and wholesalers feel. And that the same phenomenon that drove that drove the reaction of retailers. Retailers wanted more product in their tanks. Wholesalers wanted more storage, because they thought the price was going to go up. Everybody was trying to build inventory. And at the base level, it happened at the consumer level. But I think it happened all the way through the system.

Senator Lieberman. Sir, are you really contending that an increased consumer demand last Thursday morning or Friday morning is what caused this whole problem?

Mr. Chisholm. I am not saying that. I am saying that increased demand was a factor in the dynamic. I'm not saying that caused the whole problem; it was increased demand throughout the entire system. Everybody saw prices going up. Everybody wanted to have their tanks full when the prices went up, before they went up again. And that is not just the consumers. That is my members, that is the retail service station dealers, that is everyone.

Senator Lieberman. Okay, respectfully, I cannot buy it. Maybe I will come to a day where I cannot buy gasoline. But I certainly cannot buy that explanation because I have not seen it.

Mr. DiBona. Well, we collect the supply/demand statistics and we track what is happening. And for the first 27 days of July, wholesale gasoline demand, which has been soft all year—that is, down a couple of percentage points compared to a year ago—was up over 6 percent. And we think, in large part, that occurred because OPEC was raising prices at that time. And, in fact, crude prices have gone up between June 15th and the beginning of this problem by $4.50 per barrel. And that was starting to be reflected in the statistics.

The situation was not reflected completely in gasoline prices, but apparently wholesale gasoline buyers were getting nervous about it. So their demand actually went up 6 percent.

Senator Lieberman. And of course, that was before the invasion.

Mr. DiBona. That is right. So that whatever was going on there could have been accelerated.

Senator Lieberman. It is hard for me to understand, because just intuitively, I have not seen it. And it is asking a lot of foresightedness by the consuming public to go out and top off——

Mr. Tilton. It would be helpful to separate——

Senator Lieberman. There are a lot of people you can blame here. I do not think it should be the consumer.

Mr. Tilton. I think you have to make a distinction between the reseller and a consumer. And I think that Mr. Chisholm's point is well made. But I think we have to recognize, Senator, that these are considerable businessmen in their own right, who, as I said in my discussion with Senator Bryan, are actually watching that reference price and making a decision as to when to buy and when to fill those tanks.

Senator Lieberman. Mr. Tilton, let me ask you a final question, which is a different kind of question.

You indicated earlier, I believe, that Texaco has some kind of partnership relationship with the Saudis?

Mr. Tilton. That is correct. We operate a joint venture with them, yes, sir.

Senator Lieberman. Right. Let us go forward and forget our arguments about whether there is an ample supply in the world markets and the American inventory or not.

Are the Saudis prepared, do you think, from your experience and contact, to raise their output, as they are capable of doing, to help both you and the U.S. generally to meet the gap that will be created, by the boycott of Iraqi and Kuwaiti oil?

Mr. TILTON. Senator, I have no basis to make a reply to the question, really. My association with them is based on their obligation to continue to supply their requirement to our venture. What their supply decisions are going to be beyond that, I frankly do not know.

Senator LIEBERMAN. Thank you.

Thank you, Mr. Chairman.

Senator BRYAN. Thank you very much, Senator Lieberman.

Gentlemen, we may or we may not, as the lawyers say, have had a meeting of minds. But we certainly appreciate your testimony here today.

I would make just one passing comment. If, as has been discussed by each of you, the psychology of the marketplace is driving these numbers and you are just responding, making that statement without acknowledging of conceding it, I agree with the point that you're making.

It seems to me that one thing the oil industry could do in this country is to help to alleviate the concerns that have been engendered that there is this impending oil shortage, and perhaps help to reverse that psychology in the marketplace, to reassure the people that there is not an immediate cause for alarm or crisis in the sense that some of you have suggested.

I would agree with Senator Lieberman. I see no intuitive evidence that people are racing out in the still of the evening to their gas station and filling up, or before going to work in the morning.

We all went through that in the 1970's. You always wanted to have a full tank, and you would stop off when your tank was three-quarters of a tank full because you were not sure what was going to happen the next day.

I have seen no evidence of that. This may be a point on which we disagree. But, certainly, to reassure the American public that there is an adequate supply of gas I think would be an enormously helpful thing and in the public interest. I would encourage you to consider doing so.

We thank you very much for being here.

Our final panel consists of the Department of Energy, who also has been wandering back and forth between the two Houses. We have Mr. John J. Easton, who is the Assistant Secretary for International Affairs and Energy Emergencies.

I believe Mr. Easton has with him a team that he might want to invite to join him at the table.

Mr. Easton, whatever protocol you care to observe, we tender that option to you.

We would be delighted to hear your testimony. I see that we have Mr. Gentile also. Is that who accompanies you?

STATEMENT OF JOHN J. EASTON, JR., ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS AND ENERGY EMERGENCIES, DEPARTMENT OF ENERGY, ACCOMPANIED BY CALVIN KENT, ADMINISTRATOR, ENERGY INFORMATION ADMINISTRATION; AND RICHARD FURIGA, DEPUTY SECRETARY FOR PETROLEUM RESERVES

Mr. EASTON. I have Mr. Furiga, who is the Deputy Assistant Secretary in Fossil Energy for the Strategic Petroleum Reserve on my right. On my left, to your right, is Dr. Calvin Kent. Dr. Kent is the new Administrator of the Energy Information Administration, recently confirmed and sworn in last night at about 7:00 p.m.

Senator BRYAN. We congratulate him.

If memory serves me correctly, Mr. Easton, like Senator Lieberman and I, at one time you masqueraded in life with a different title, that of Attorney General of your State.

Mr. EASTON. That's correct, Mr. Chairman. The three of us had the pleasure of serving together. I guess this is my first time before you and your Committee.

I appreciate the opportunity to be here. I am not sure that we can add much light to this difficult subject of pricing. But let me at least tell you where we, at the Department of Energy, stand, and try to answer your questions.

Senator BRYAN. We would be pleased to hear from you.

Mr. EASTON. What I would like to do is discuss the current situation as we see it in the petroleum market and then bring you up to date on what the Department of Energy is doing to monitor supplies following the invasion of Kuwait by Iraq last week. I will discuss two points today.

First is the current supply in the world oil market, as we see it. Second is what the Department of Energy is doing to address potential supply problems.

First, let's discuss the supply of crude oil.

I think you have heard from previous witnesses that U.S. commercial crude stocks are at their highest level in 9 years. Our numbers show about 392 million barrels.

Worldwide, the amount of oil held in commercial stocks is at the highest level since the late 1970's. So, presently—and "presently" is a very transitory term; it changes almost hour by hour—presently, there is not a significant shortfall in the availability of crude oil on the market.

Senator BRYAN. Mr. Easton, could we ask you to repeat that again for the record, please? That is something which, maybe if we repeat it often enough, some of us will fully understand. I think that is a very significant statement and I think it is very accurately framed from my perspective.

Mr. EASTON. Well, as I said I think before, I said presently—and that is a very transitory term; it changes hour by hour in these very changing circumstances—there is not a significant shortfall in the availability of crude oil on the market.

In addition, there is unused production capacity in many countries around the world. This capacity could be brought on-line if there is an interruption of oil supplies from the Middle East.

The U.S. Strategic Petroleum Reserve, or SPR, holds almost 590 million barrels, and our allies hold additional strategic stocks as well. A point I made at the last hearing should be emphasized, and that is we are prepared to use the Strategic Petroleum Reserve to address any severe energy supply interruption in this country, and we will coordinate this with our allies.

Now, I would like to explain what we have been doing since this crisis erupted.

We have been looking at a variety of scenarios and what actions we might take, and we have been developing a strategy to deal with a range of contingencies. This includes a full assessment of the Strategic Petroleum Reserve and how and when we might use this resource.

Secondly, the Department of Energy worked closely with the Department of Treasury late last week to insure that oil from Iraq and Kuwait currently en route to the United States and already purchased by U.S. companies would be allowed to enter the U.S. and, thereby, obviate possible localized disruption problems.

Thirdly, we are preparing to meet with our allies in the North Atlantic Treaty Organization—that will occur tomorrow—and also with the EC tomorrow, and then with our partners in the International Energy Agency, and that will occur on Thursday, in order to insure that our actions in response to the events in the Persian Gulf are well coordinated.

We think this will improve the effectiveness of all our responses.

I want to say a brief word about the recent price increases.

As normally occurs with any disturbance in the international petroleum market, prices of crude oil rose quickly on the spot and futures markets. These price increases have been effected in varying amounts in retail gasoline prices. It is difficult to predict further price movements because of the speculative nature of both the spot and futures markets.

Price volatility occurs because it is unclear how long any temporary losses of oil will last and how readily the market will be able to absorb such losses. Since these events take time to translate into real impacts on the availability of oil, the market is reacting speculatively as to the future.

Of course the Department is concerned. We are concerned about the rapid run-up in the price of petroleum products. However, the impacts of recent events on the oil market are still unknown. Therefore, we should not attempt to predict future price movements. We will continue to monitor the situation and will share information about possible anticompetitive activities with the Antitrust Division of the Department of Justice and will draw down the SPR if the severity of the situation warrants it.

Mr. Chairman, I am pleased to conclude my statement and take any questions that you or Senator Lieberman might have.

Senator **Bryan**. Thank you very much, Mr. Easton.

Let me ask you just a couple of questions, if I may. I know that we have gone long beyond the time that we contemplated for this hearing.

I hear you saying that you are prepared to use the Strategic Petroleum Reserves to assure availability. I think that was the operative term that you used.

Mr. **Easton**. That is correct.

Senator **Bryan**. The previous panel, or at least one member thereof, suggested, as have other Members of the Congress, that the Strategic Petroleum Reserve might also be used for another purpose, that is, namely, to help to restore some stability in the pricing structure.

Mr. Easton, does the Department rule that out as an option?

Mr. **Easton**. We do not see the use of the SPR as a vehicle primarily to dampen prices. We think, however, that prices will respond to the use of the SPR.

We feel that we are guided by the statute which requires us to use the SPR or recommend to the President that it be used for a severe energy supply interruption. We can take into account one of the three factors that has to be taken into account, which is the effect on the economy.

So we believe that economic considerations can be factored in and must be factored in as one of the three tests that must be used. But we do not see the SPR used primarily to dampen or control prices. That would be an obvious result, we think, once it should be drawn, but not the primary reason for using it.

Senator **Bryan**. Mr. Easton, there seems to me to be a policy and perhaps a legal distinction. Let me again ask you to revert to your former life for a moment.

I understand you to be saying that it is the Department's view that, in terms of policy, the Strategic Petroleum Reserve ought not to be used to influence pricing. And yet, I understand you to say that one of the predicates that can be considered—and perhaps you are talking now about the legal threshold, the trigger that empowers the President to act—is the impact this may have on the economy.

Pretty clearly there has been some testimony here, and you know it intuitively, as do all of us, that what we see out there at the gas pump is only the tip of the iceberg of what is happening in the economy because there is a rippling impact. The truckers were in here today and indicated what is happening with respect to their industry, which represents, as we were told, 5 percent of the Gross National Product.

My question to you is a narrowly focused one.

If you should choose, as a matter of policy—italicizing the word "if"—would the President have the authority to use the Strategic Petroleum Reserve to help to restore some price stability, from a legal point of view?

Mr. **Easton**. Well, I should let our General Counsel provide the legal advice.

As you know, practicing law when we don't ordinarily do it may be difficult.

Let me try to answer your question by saying that there are three tests of the statute, the middle test being that this severe energy supply interruption may cause major adverse impact on national safety or the national economy.

So that would be the threshold we would have to look at to see whether that test has been met, the presence or likelihood of a major adverse impact. That would be one, along with two others, that have to be met.

Senator BRYAN. Is that in the disjunctive, Mr. Easton, or the conjunctive? Now I know we are talking a lot af legalese and mumbo jumbo here that does not always make a lot of sense to the public. But is it "either/or" or each of the items?

Mr. EASTON. Each of the three tests have to be met, Mr. Chairman. The first is that it is or is likely to be of significant scope and duration. It also has to be of an emergency nature. The second is that it may cause a major adverse impact on national safety or the national economy. The third test, which also must be met, is that it results or is likely to result from an interruption in the supply of imported petroleum products or from sabotage or from act of God.

Senator BRYAN. Let me retrace part of your testimony now in terms of the quantities that we have. The 590 million barrels is in the Strategic Petroleum Reserve as I understand it.

Mr. EASTON. That's right.

Senator BRYAN. That is a calculation separate and apart from the industry itself—that is, the refineries, any intermediate distributors in that network of supply and distribution.

Am I correct in that?

Mr. EASTON. That is correct. Yes, sir.

Senator BRYAN. What number did you give us that would indicate inventory above and beyond the 590 million? I thought you said 392 million.

Mr. EASTON. That's the number I gave you. Yes, sir.

Senator BRYAN. So that would be above and beyond the 590 million?

Mr. EASTON. That's correct.

Senator BRYAN. Would the 392 million barrels that would be industry-inventoried in that supply and distribution network be at or near record levels, insofar as you know?

Mr. EASTON. That is at their highest level in the last 9 years. So, certainly, it's the highest since early in the last decade.

Senator BRYAN. I believe you shared with us a global perspective indicating that in terms of the international picture, it, too, is much brighter than it has been in terms of the amount of reserves that are on-hand.

Mr. EASTON. Worldwide, it is the highest since the late 1970's.

Senator BRYAN. Since the late 1970's, then.

Have you had a chance to look at any data regarding this sharp run-up in prices? Indeed, one of the agencies within your Department has produced information reflected in a graph which is pretty compelling.

My question is, are we experiencing world-wide the kind of pricing phenomena, at the retail price levels, for example, in Europe and Japan, that American consumers are experiencing?

Mr. EASTON. I have access to what is happening in the crude markets around the world.

Perhaps Dr. Kent may have access on gasoline markets, but I'm not sure.

Senator BRYAN. I would be interested in the retail price, Dr. Kent. One would think that, with all of the vagaries of the pricing system and the psychology of the market and all of these intangibles that have been discussed earlier, we would see the same phenomena in Europe and Japan, this rather sharp run-up. The evidence before us would indicate that, as recently as a few hours—not days, but a few hours—after the Iraqi invasion, indeed some of the major refineries were posting sharp increases within their supply network.

Is that happening, if you know, in Europe an Japan?

Dr. **Kent**. I have no knowledge of what is going on there. We can check into that and get back for the record to you, if you would like.

Senator **Bryan**. That would be helpful. We would leave the record open, Dr. Kent, for you and others to respond and to give us that information.

[The following information was subsequently received for the record:]

Motor gasoline prices are generally higher in other developed countries because of higher taxes. Attached is a table that compares recent retail gasoline prices before and after the takeover of Kuwait by Iraq (August 2). The prices are shown both including taxes and excluding taxes. All the prices are at the retail level. The increase per gallon at the retail level (including taxes) ranged from 6 cents to 34 cents in other countries. The average U.S. retail price went up 15 cents during the time of July 30, 1990 to August 13, 1990. Wholesale gasoline price information is not reported by foreign countries.

RECENT ESTIMATED INTERNATIONAL RETAIL PRICES FOR MOTOR GASOLINE

[Price in U.S. dollars; per U.S. gallon—1990]

Selected countries	Including taxes		Excluding taxes	
	July 30, 1990	August 13, 1990	July 30, 1990	August 13, 1990
Belgium	3.37	3.50	1.18	1.27
France	3.40	3.67	.88	1.05
Germany	2.76	3.04	1.05	1.27
Italy	4.58	4.90	1.10	1.19
Netherlands	3.48	3.65	1.22	1.32
United Kingdom	3.02	3.36	1.15	1.32
Japan	3.04	3.10	1.69	1.76
United States	1.07	1.22	.82	.97

Note.—European prices are for premium leaded gasoline. Prices for Japan and the United States are for unleaded regular gasoline. Taxes are estimated.

Sources: European Prices—"Weekly Oil Bulletin" for the European Economic Community.
Japan—U.S. Embassy in Tokyo and the Economic Research Association for Japan.
United States—American Automobile Association.

Senator **Bryan**. There also has been a question that I think would be helpful to clarify for the record, Mr. Easton.

When the Department estimates the duration that this supply will last, one of the witnesses that appeared here prior to your testimony indicated that the number of days referred only to the gap that exists between world demand and world supply for an indefinite period of time that the Iraqi and Kuwaiti production is taken out of the international market by reason of the boycott.

Some of us had the impression that the figures you were giving us, or that the Department was giving us, referred to the total consumption in the United States.

Would you clarify that for us. When you tell us we have X number of days of supply available in the Strategic Reserve and in the inventories that the industry has, does that refer to total consumption in America, or are we talking about the gap that may exist by reason of this production that is taken off the market?

Mr. EASTON. I guess it depends on how the question is phrased. When I was here earlier, I heard some discussion, while waiting to testify, about the figures in the "Financial Times." Senator Lieberman was asking one of the witnesses about those figures.

I think the answer was that those figures seemed to be referring to the days of covering the disruption that might occur. But I am just speculating.

Let me try to refer you to how we measure it.

I don't know that I gave you any days of coverage in my oral statement.

Senator BRYAN. You did not.

Mr. EASTON. We normally refer to a goal that the International Energy Agency member countries have of keeping a combined government plus commercial stocks equal to 90 days of their imports. So, in our case, we are importing somewhat just in excess of 7 million barrels a day. So we would want to keep a combined commercial stock and government stock to meet our IEA commitment of at least 90 days of total U.S. imports.

Our Strategic Petroleum Reserve at the moment, close to 590 million barrels, is roughly 75 days or so.

In addition, the corporate owned, company stocks give us another 25 days of coverage.

I think those are above the minimum operating level.

Senator BRYAN. Would that be about 100 days, then, combined?

Mr. EASTON. Yes, 100 days above minimum operating level. This is assuming total loss of all imports.

Senator BRYAN. Total in projection of imports.

Mr. EASTON. What should be realized is that we do import from a number of countries, such as Canada, Mexico, the U.K., Norway, and the like.

Senator BRYAN. If you don't have it handy, would you provide this.

Assume for the sake of argument that for an indefinite period of time the Iraqi and Kuwaiti oil production is taken out of the international marketplace. Also assume that the full brunt of that would be borne by the American market. That would not be a total interdiction of imports. But, under the hypothesis of the question, it would create a net shortfall in terms of the amount that we consume.

How many days would we have available, combined government and private sector sources?

Mr. EASTON. We used a figure last week when we were referring only to the amount that we imported, which was roughly 610,000 barrels a day from Iraq, and another 120,000 from Kuwait. That's 730,000 barrels a day. We used a figure last week that our 590 million barrels was over 800 days of coverage that way.

If we looked at what the two countries have been producing and take that out of the market, the figures vary. But we figure that their exports—not their production, but their exports—are roughly 4.5 million barrels a day. If that were borne under the highly unlikely scenario totally by the United States, it would be the 4.5 million divided into the 590 million, whatever that comes to, which certainly is in excess of 100 days for withstanding that oil disruption, if we were the only ones who were losing it, and that would not be the case.

Senator BRYAN. It's a very, very unlikely scenario. I appreciate that.

Mr. Easton, we appreciate you and your colleagues waiting so patiently and being here.

Let me give them an opportunity, if they wish, to make a comment or two before we wrap up this hearing.

Dr. Kent, did you have a comment?

Dr. KENT. I have nothing to add but am available to answer any questions that you might have.

Senator BRYAN. Senator Kerry has rejoined us.

Did you have any questions for the Department?

Senator KERRY. I do, if I may, and I apologize for what I gather is a timely return.

I just want to ask a couple of questions.

First of all, were you here during the testimony of the oil companies?

Mr. EASTON. I arrived toward the end, Senator. I cannot tell you at what point I came in, though.

Senator KERRY. Were you with them in the House?

Mr. EASTON. I was with them during part of it in the House. Yes.

Senator KERRY. So you had a chance to hear the substance of their rationale for why the price increase has taken place. Is that correct?

Mr. EASTON. Correct. Yes, sir.

Senator KERRY, Their principal allegation I think raises a very significant policy issue, which is why I wanted to come back to ask you a couple of questions. Their fundamental rationale is that the market is setting the price and the spot market is moving with such volatility that they have to respond. Correct?

Mr. EASTON. Yes.

Senator KERRY. Do you agree with that?

Has this already been discussed, Mr. Chairman.

Senator BRYAN. No, not yet. Go ahead.

Senator KERRY. Do you agree with that?

Mr. EASTON. This is a new line of questioning, Senator. Before I answer whether I agree, let me share with you what I said earlier, because the simple answer to your question is I think it is more complex than that. And yet, I am not an economist nor one who markets.

Senator KERRY. I understand that. But you are speaking here as the Administration's and the Department of Energy representative. Correct?

Mr. EASTON. Yes. That is why I wanted to share with you what I had said about pricing just a minute ago, so you would hear what our position is on that. It is not that definitive in terms of giving you an answer to your question. But it will at least give you the administration's view, our view, on pricing, if you wish.

Senator KERRY. Can you do it tightly?

Mr. EASTON. Sure. I will.

I had said earlier that whenever there is a disturbance in the international petroleum market, prices of crude will rise quickly, as they did in this case, on both the spot and futures markets, and these price increases have been reflected in varying amounts in the retail gasoline prices. It is difficult to predict future price movements because of the speculative nature of both the spot and futures markets.

I went on to say that price volatility occurs because it is unclear how long any of the temporary losses in oil supplies will last or how readily the market will be able to absorb such losses.

Senator KERRY. What you have talked about is the spot market and the futures market.

Mr. EASTON. That's correct.

Senator KERRY. Is there any reason that within two days, the prices should go up at the pump in the way they have as a reflection of either of those two markets' prices?

Mr. EASTON. Well, one of your witnesses said that one of the factors on which they price their product, one of the indicators, are those two markets.

Senator KERRY. Well, evidently it is controlling. I heard him say there are many indicators. This is one of the indicators. But the bottom line has become that it is fundamentally the controlling indicator. That is the bottom line of the testimony we heard today.

Should it be?

Mr. EASTON. We, as a Department, are concerned about the rapid run-up in price.

When I was here before this——

Senator KERRY. Well, let me get away from "concern." The American people are justifiably angry. We are upset. We are questioning. But they don't want "concern." We want to know whether or not it is justifiable.

Can anyone tell us? Can anyone in the administration tell us whether, from their experience and expertise, this is a justifiable increase?

Mr. EASTON. I think at this point it is simply too early for us to be able to explain whether it is justifiable or not. We do not have the answers.

Senator KERRY. Why not?

Mr. EASTON. The answers depend—and Dr. Kent can probably explain it much better than I—the answers depend somewhat on the same sort of analysis the Energy Information Administration had to use last year in determining acquisition costs, margins, profits, and the like. You don't have that information available to you at any level when it is happening.

We have hour by hour information about what the prices are on the crude markets and for the wholesale level. We do not have even accurate information at the retail level. So it is very difficult to tell you whether or where there are excessive profits. We could not do that until we did a very thorough analysis of actually what is being paid, what the refiner's acquisition costs are for the product they are buying.

Senator KERRY. Well, why do we not track that on a regular basis? Haven't we learned by now?

Mr. EASTON. We do track that.

Senator KERRY. Don't we have a computer model into which all of this gets entered and which can produce a daily analysis on this?

Mr. **Easton**. Perhaps Dr. Kent can explain his models and the data he collects better than I can. But let me suggest to you that this sort of information, in order to tell you whether prices are excessive, there are exorbitant profits, or any such thing, depends on a lot of information that simply is not available on a real-time basis, as I understand it.

Senator **Kerry**. Dr. Kent, do you want to help us out here, and can you pull the microphone closer to you?

Is this something that we cannot track on a real-time basis?

Dr. **Kent**. If you are talking about crude oil process, we are now in the process of tracking that on an hourly basis.

Senator **Kerry**. Why didn't we track it on an hourly basis before this event? We have been through this before.

Dr. **Kent**. We have been tracking it on a daily basis.

Senator **Kerry**. Well, isn't it sufficient on a daily basis, with the other input available, to be able to determine the impact on the market and whether or not it is justifiable to raise prices?

Obviously the oil companies base their decision to raise prices on some things, we presume. That is the whole issue here. If they can make the decision to raise the price, why can't we follow that?

Mr. **Easton**. You are asking for us to give a value judgment on their decision——

Senator **Kerry**. That's right.

Mr. **Easton**. Which they tell you is set by a market' much larger than they themselves independently are. Then you are asking us to give an independent value judgment.

We have the data; but I don't know that we can give you that value judgment on the basis of crude oil data.

Senator **Kerry**. Let me ask you this.

Without making a judgment about whether or not they were justified, can you make the judgment as to whether or not those two markets should control whether or not they raise prices?

I mean, they are suggesting to us that they don't set the price, that they get set by the market out there.

Mr. **Easton**. I guess it comes down to a fundamental belief: do you believe that the markets themselves are competitive or not in order to determine whether the prices are justified. If you don't believe the markets are competitive, then that may help to answer the question.

Senator **Kerry**. Do you believe they are competitive?

Mr. **Easton**. From everything I have seen, I believe they are very competitive.

Senator **Kerry**. And if they are very competitive, are they setting the price?

Mr. **Easton**. They seem to be, in certain markets.

Senator **Kerry**. Which markets are setting the price?

Mr. **Easton**. Well, when I use the word "market," you have several places where the markets function. You have the Mercantile Exchanges here and abroad. You have spot markets which exist, sometimes contemporaneously and sometimes differently. You have the marketplace determined by you, as a seller, and me, as a buyer, doing business with each other. That is a marketplace.

Senator **Kerry**. But, evidently, the buyers and sellers in this market, according to testimony we have heard today, do not have a lot of power to affect it, except insomuch as they are affecting the Mercantile portion of it. Am I wrong?

At the pump they do not affect it. I mean, they, themselves, said that if they lowered the price and there were significant demand, they would run out of product. So they don't lower the price. They are not competitive in that respect. It is not like any other industry, where you lower the price in order to beat your competitor. They admitted that.

I was flabbergasted by that. I frankly think there was an admission as to the noncompetitiveness of the market, at least internally.

Now, as to the worldwide piece of it, that may be different.

Mr. EASTON. Well, I heard the same information and put a different interpretation on it. The inference I drew from that is indeed the marketplace works because if they are out of sync with the price, then there will be excessive demand for their product, and low price usually implies high demand.

Senator KERRY. But what you are saying to me troubles me, because we have a release from the Department of Energy which says that a dislocation or a disruption in the Middle East should not cause prices to go up, that there is adequate supply in this country, that there should be no dislocation in supply or price in the short-term.

Now, that is your Department that said that. And yet, here you are with the very impact that you said did not have to take place having taken place. Your Department has said there was no justification, and yet you are not willing to pass judgment on it.

Was that a lot of malarkey that you put out?

Mr. EASTON. Let me say, as I said before you came into the room, Senator, that when we say there is presently no significant shortfall, that "presently" is a very transitory term. What we said last Thursday in our press conference was true as of that date, when the U.S. was the only country to embargo products out of Kuwait and Iraq.

Senator KERRY. But there is nothing that has shown a shortfall between Thursday and Sunday in the supply of crude that would drive up prices at the pump, is there?

Mr. EASTON. There is the speculation by——

Senator KERRY. Precisely, speculation—the market.

So, the question you have answered, I think, finally. The speculation is what has driven this increase.

Is that correct?

Mr. EASTON. That is in part what has driven this increase. The rest of it, I cannot tell you how much has been driven by speculation and how much has been driven by other factors.

You have heard other witnesses describe other factors.

Senator KERRY. What are the other factors that you would put into that?

Mr. EASTON. Well, you have heard from other witnesses about the factors that they use. What I am suggesting is that we see some of the movement on the crude market and on the wholesale market for gasoline. Some of that movement, maybe much of that movement, is due to speculation by traders who trade on those markets.

But the question is how much of pricing is influenced by those markets. You have heard a witness—and I am not going to try to second guess that witness—refer to the reliance they put on those. There might be other witnesses who might say something different.

Senator **KERRY**. Well, I think it brings us to a very important and fundamental policy issue, which is really at the heart of what these hearings perhaps are about or ought to be about. That is the question of what change may now have taken place in the supply of crude oil and ultimately of petroleum products to this country that has a negative impact on our economy and potentially could cause a recession or play into a very, very dangerous set of circumstances, economically and otherwise. To what extent are those products now the subject of a price setting process that is speculative, rather than truly reactive to supply and demand and to competition?

To the degree that there may not be competition there now and to the degree that it is subject to speculation, do we, as a nation, want such an important product that has such an impact on our economy to be subjected to this speculation?

It seems to me the entire concept of a Strategic Petroleum Reserve was geared toward the avoidance of that very kind of possibility. I wonder whether you and the Department are making any recommendations to the President that we adjust against that speculation by creating some other means of putting greater market force back into the marketplace.

Mr. **EASTON**. The answer is no.

We believe the markets are competitive. We believe there is more than one market. The market we have been discussing in here is one market, where there is a lot of speculation in the last few days.

When we refer to "markets," the markets are much larger than just that market.

You heard from a witness—and I did not hear all his testimony—but you evidently took away from what he said that, the spot and futures markets controlled what they did. I am not sure that that is necessarily the way things work, but I cannot argue with that.

But I can say the marketplace is much, much broader. It is brokers brokering oil. It is people buying oil under long-term contracts. Those contracts sometimes are subject to price adjustment clauses, sometimes perhaps not. It is a very large and diffuse marketplace. It is a worldwide marketplace these days. There is no longer just a U.S. market for oil. Oil is fungible. It is traded around the world.

In some respects, what happens on a speculative market, like the New York Mercantile, will indeed make the market function as it should, as it did last winter, when prices were driven up quickly. It attracted a lot of supply. The market was over-supplied and prices came back down. When prices go up, demand tends to slacken because of people finding either alternative sources or engaging in conservation or what have you.

So, we find the marketplace still very competitive, and, therefore, I will not be recommending the institution of any sort of controls in the marketplace.

Senator **KERRY**. I am not talking about controls. I am talking about perhaps some influence.

I am not in favor of coming back in, certainly not returning to the 1970's and those kinds of controls. But the question is, if you are looking at a short-term interruption of a marginal amount of our oil supply and there is a capacity to draw down on other sources in order to make up for it—i.e., increased production in Saudi Arabia; increased production from other countries; purchases, our own conceivably, or even other sources; conservation; whatever— it seems to me that maybe, because of the fragility of our economy, currently, avoidance of a two to three week impact, as we may see, and maybe longer, by drawing down on a certain number of days of the Strategic Petroleum Reserve might make a lot of sense for the economy of this country.

I think at least it ought to be debated. It ought not to be dismissed out of hand.

That is all I suggesting.

Mr. **EASTON**. We have not dismissed out of hand the use of the SPR. I said in my oral remarks that we are prepared to use it if the condition of the statute is met, which is a severe energy supply interruption.

Senator **KERRY**. I appreciate your answers and your comments. I think the whole question of the volatility of this market and the nature of competition within it is a larger issue to be explored.

I will reserve further comments.

Mr. Chairman, you have been very indulgent. Thank you very much.

Senator **BRYAN**. Thank you very much, Senator Kerry. We appreciate the line of questioning you have developed.

Mr. Easton, we appreciate your being here today, as well as your colleagues who sit to your left and right.

This Subcommittee hearing will stand adjourned.

[Whereupon, at 2:50 p.m., the Subcommittee adjourned, to reconvene upon the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF HON. BOB DOLE, U.S. SENATOR FROM KANSAS

Mr. Chairman, I want to thank you for the opportunity to submit written testimony at this hearing.

Like most Americans, I am deeply troubled by the sudden rise in retail gasoline prices that has occurred during the past several days. In my home State of Kansas, for example, the average retail price of gasoline has increased by 15 cents—from 94 cents to $1.09 per gallon. In other areas of the country, gasoline prices have risen by as much as 25 cents per gallon.

Most experts agree that these price increases cannot be justified by the Iraqi invasion of Kuwait, since the full impact of the invasion on the market price of crude oil will not be felt for at least another 45 days. Furthermore, the decision by OPEC last month to cut oil production may justify a modest price increase, but it cannot explain the 15–20 cents per gallon increases that we are witnessing in some parts of the country.

Yesterday, I sent a letter to Attorney General Richard Thornburgh urging him to direct the Justice Department's Antitrust Division to investigate whether the recent wave of gasoline price increases can be attributed, in part, to collusive activity by individuals within the oil industry. If antitrust violations have anything to do with the soaring prices at the pump, these violations must be identified and remedied without delay.

Mr. Chairman, I ask consent that the full text of my letter to Attorney General Thornburgh be inserted in the hearing record at this point.

U.S. SENATE,
OFFICE OF THE REPUBLICAN LEADER,
Washington, DC, August 6, 1990.

Hon. RICHARD L. THORNBURGH,
Attorney General,
Department of Justice, Washington, DC.

DEAR DICK: I am writing to express my concern about the sudden rise in retail gasoline prices that has occurred during the past several days, apparently in response to an anticipated shortfall in the supply of crude oil caused by the Iraqi invasion of Kuwait.

Although gasoline prices vary regionally in this country, prices at the pump have increased by an average of 15 cents per gallon. In some areas, gasoline prices have risen by as much as 25 cents per gallon—all in a matter of a few days.

Most experts agree that these price increases cannot be justified by the Iraqi invasion of Kuwait, since the full effect of the invasion on the market price of crude oil will not be felt for at least another 45 days. Furthermore, the decision by OPEC last month to cut oil production may justify a modest price increase, but it cannot explain the 15–20 cents per gallon increases that we are seeing in some parts of the country.

Although I am not interested in pointing fingers, I am troubled by the virtual lock-step decision of the oil industry to increase gasoline prices. "Price-gouging" is a harsh term, but it is a term that seems to most aptly describe the situation we are not witnessing. I am also troubled by the remarkable "parallelism" in the pricing activities up-and-down the various distribution chains—from refiners to wholesalers, and finally, to the retailers, who pass along the price increases directly to our nation's consumers at the gas pump.

As a result, I would urge you to direct the Justice Department's Antitrust Division to investigate whether the recent wave of gasoline price increases can be attributed, in part, to collusive activity among oil refiners, wholesalers, and retailers. As you know, collusive activity leading to "price-fixing" would violate not only the spirit, but the letter, of our federal antitrust laws.

Due to the enormous inflationary effect of gasoline price increases, as well as the attendant effects of inflation on the health of the national economy, I would urge that a Justice Department review be undertaken as quickly as possible. If antitrust violations have anything to do with the soaring prices at the gas pumps, these violations should be identified and remedied without delay.

Thank you for your attention to this matter.

Sincerely,

BOB DOLE.

STATEMENT OF SHELL OIL COMPANY

PETROLEUM PRICING

Crude oil and petroleum products such as gasoline, diesel fuel, etc., have evolved into true world commodities, traded on futures exchanges in various world trading centers, in a manner similar to precious metals, agricultural products and financial instruments. These commodities are subject to fluctuations in perceived value in a worldwide market, value that is established by both current supply and demand and perceptions of future supply and demand.

The U. S. market is not, nor can it be, insulated from the world market for crude oil and petroleum products. The United States is now dependent on foreign sources for nearly 50% of its total crude oil supply, as well as large volumes of refined products (during the first half of 1990, the U. S. imported about 400 thousand barrels per day of gasoline).

The world market in which crude oil and petroleum products are traded has reacted in a most predictable way to the prospect of the removal of the more than four million barrels per day of crude oil production from world supply. As a result of actions by the government of Iraq and the initial public statements made by other OPEC countries that they would not increase production to make up the supply shortfall, prices have risen significantly, and could well continue to rise reflecting the perceived risk of supply shortfalls. Any unwillingness of U. S. petroleum companies to be competitive with others bidding for available oil supplies would likely result in the perception of even greater domestic shortages in the short term and the possibility of real shortages in the longer term.

The nature of the crude oil and petroleum products markets has changed substantially over the past decade. In the early 1980's, most international oil was purchased under long term contracts from producers at fixed government selling prices which tended to be adjusted very slowly and lagged the market by months. Today, oil prices are set at current market-related values (spot prices) near the time of delivery, not when the cargo was shipped or title transferred. Consequently, the refiners' costs for products being placed into the distribution system are "current" and reflect present market values. As part of this process, contract prices are typically indexed to recognized published spot market prices for crude oil or finished products. These spot prices are public information available electronically from news or price services and generally represent the transaction price for current delivery of crude oil. Accordingly, crude oil prices have tended to converge to a worldwide price structure related to very current spot values. The instancy and volatility of pricing has further increased with the growth of a regulated futures exchange clearinghouse allowing open call buying/selling of petroleum products to both petroleum industry participants and non-participants such as bankers, commodity traders, and speculators.

Many gasoline refiners are also buyers of gasoline depending on grade, season, geographic region, and the operational status of their refinery capacity. Because oil purchases are routinely transacted at prevailing spot values near delivery, the time lag for the product being offered for resale to the ultimate consumer at the service station may be only a few days. For those barrels which are occasionally purchased on a fixed price basis in advance of either refining or selling, the pricing risk may be hedged by selling futures on a commodities market in order to keep the transaction tied to current market conditions at the time of sale and reduce the timing risk associated with the transaction.

To the extent that competitive market prices permit, the refiners and marketers of gasoline will also endeavor to price their products at what they believe are their replacement costs. To do otherwise would equate to liquidation of the business. In commodities, consistently pricing product in a rising market on an historical cost basis rather than marketplace competition can result in both a run on that marketer's available supply depleting it before his competitors' supply is depleted, and a cash shortfall from current inventory sales being sufficient to replace that same volume of inventory. The concept of replacement costs pushing current marketplace prices in commodity sales is sound business practice that, over time, can minimize supply disruptions at fair market values in both rising and declining markets.

Gasoline reaches consumers through a distribution network made up of major and independent refiners, trading companies, hundreds of individual distributors and resellers, and thousands of retail dealers. This necessitates that individual pricing decisions and supply alternatives have to be made by an array of independent businesses, reselling in an open and diverse competitive environment. In fact, gasolines are commonly sold at different prices by different dealers in the same marketing area. At each transaction level, the buyer and seller must ultimately make independent business decisions based on their perceptions of supply, demand, current market conditions and future potential market outcomes. The competition at each level of the channels of distribution generally tends to keep a competitive check on price increases being passed along to the consumer in a rising market.

To the benefit of the consumer, the petroleum business has become increasingly competitive, and today no single company has as much as 9% of the U. S. gasoline market. As in any vigorous, competitive industry, refining and marketing has been characterized by the entry of new competitors, the exit of obsolete and non-competitive firms, and a merging of some firms to achieve a more competitive position. The net result of this "turn-over" of refining and marketing companies has been more effective competition.

Although driven by slightly different factors, recent history shows that sharp changes in supply or demand in the petroleum marketplace have caused prices to move rapidly, both up and down, driven by natural market forces. Following are some recent illustrations.

The VALDEZ oil spill incident in April 1989 was what we might call a market-push event. In reality, the VALDEZ spill itself did not cause product price increases but affected the timing of product price moves because of fundamentals already existing in the marketplace.

Prior to the spill, product prices had lagged behind the crude price increases which took place over the winter of 1988/1989 (from a low point in 1988 into the spring of '89, crude prices rose 18 cpg whereas product prices were essentially flat). In the 1st/2nd Qtr. 1989, product inventories were drawn down due to high refinery turnaround and shutdown activity including unscheduled problems. By March 1989 these factors were placing upward pressure on product prices, which started to move up prior to the spill. The VALDEZ incident gravely aggravated the situation, especially on the West Coast, because of a sudden disruption in the supply chain for crude oil. Immediately after the spill, West Coast spot gasoline prices increased 34 cents per gallon in four days. As the uncertainty of crude deliveries eased, gasoline prices declined 20 cents per gallon in 12 days, and over the next month decreased an additional 13 cents per gallon.

Another significant market event was the cold winter freeze of December 1989. A major disruption in refiners' petroleum product availability was perceived to be imminent due to freeze damage to a number of U. S. Gulf Coast refineries. This was a market-pull event. The unexpected hard freeze across a wide part of the U. S. Gulf Coast had a major impact on shutting down much of the refining sector. The market perceived a prompt shortage developing because supply would be insufficient near term to meet expected winter demand. Consequently, demand increased immediately as buyers were willing to pay more for supply continuity and avoid future price increases. The wholesale price of No. 2 oil shot up. Higher prices creating production incentives for those refiners unaffected by the freeze and refineries restreaming after the freeze caused more production to eventually be brought to the marketplace. This, then coupled with relatively warm weather for the remainder of the winter, generated a market perception that a surplus was developing and prices fell sharply. During this event spot No. 2 oil prices increased 19 cents per gallon over a six day period, and after refiners assessed the damage to their process equipment and reassured the market of their ability to meet demand, prices decreased 22 cents per gallon over a four day period.

The Iraq invasion of Kuwait appears to be a market-pull event. OPEC reached an agreement on July 27, 1990, to increase crude oil price from $18 to $21 a barrel and limit production to 22.5 million barrels a day. In anticipation of these agreements, crude oil prices began increasing in early July, and by August 1, the day prior to the Iraqi invasion of Kuwait, spot crude prices had increased approximately $4 a barrel (or about 10¢/gallon), while typical wholesale gasoline prices remained essentially flat.

The trade sanctions against Iraq had an immediate effect because the market perceived that the sanctions against Iraqi and Kuwaiti oil would withdraw more than 4 million barrels a day of crude oil from the world supply. For perspective, this is comparable to the supply disruption that occurred during the 1973 embargo and twice the net shortfall associated with the Iran-Iraq war in 1979. Fears of significant potential product shortages caused the spot market price to escalate rapidly.

Between August 1 and August 7, crude prices increased an additional $8 a barrel bringing the total increase from early July to $12 a barrel, (or more than 29¢ per gallon). In the same period, typical major oil company prices to dealers moved up about 9¢ per gallon. (See chart #1).

With gasoline supplies already tight in some areas of the country because of environmental regulations and refinery processing unit shutdowns, the market instantaneously placed more value on oil available in the distribution chain. Commodity market buyers scrambled to cover short positions, and refiners attempted to begin trying to replace finished product supply. As a result, a sharp escalation occurred immediately in spot market prices for both raw materials and finished products.

As the crisis has continued, speculation on future Middle East developments has brought daily volatility to the crude oil market. Pressures on product prices have generally continued as demand throughout the complex distribution chain has increased as people "stock up".

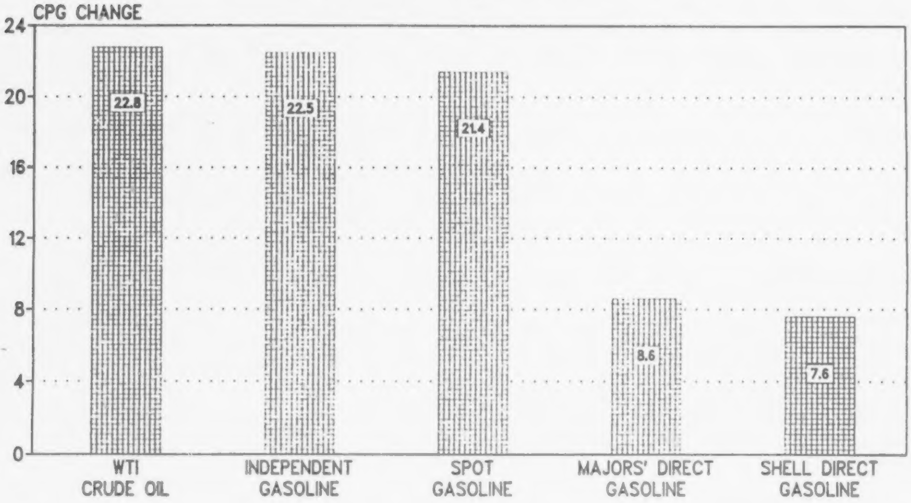
Shell believes the free market has historically and will continue to assure U. S. consumers adequate supplies of gasoline at fair prices under virtually all supply/demand scenarios. During the 1980's, despite the perplexing cycles brought on by sudden large scale disruptions, the natural forces of supply and demand in a system of highly competitive free enterprises have actually resulted in lower average consumer gasoline prices in August, 1990 than in 1980, defying 50.5% inflation in the consumer price index in the interim. During the same period virtually every other major consumer product group has increased significantly in cost (see charts #2 and #3). The competition within the petroleum industry is also apparent in its relative profitability. A common measure of profitability is percent return on equity. Data from the Bureau of Census provides an overview of how the petroleum and coal industry has performed in this area versus other industrial segments. Over the last five years (as shown in chart #4), the petroleum and coal segment trail most other industries in percent return on equity, as defined as net income after taxes divided by stockholders' equity. If one were to examine the data over the last two decades, only during the period of government controls in the late 1970's did petroleum and coal consistently outperform other industrial segments.

Shell shares the concern of the nation over the crisis in the Middle East and its impact on energy security and prices. (See chart #5). Since the Iraqi invasion of Kuwait, crude oil prices have increased approximately 35 percent, and the openly traded market for gasoline supplies has jumped about 20 cents a gallon. While Shell Oil's gasoline price has varied by region and class of trade, our average increase has been only about one-half of this price rise. However, we also firmly believe that barring a national emergency the government should encourage the free market mechanisms to set prices to insure adequate supply.

CHART #1

AVERAGE CHANGE IN PRICE - TOTAL U.S.

July 9 To August 8, 1990

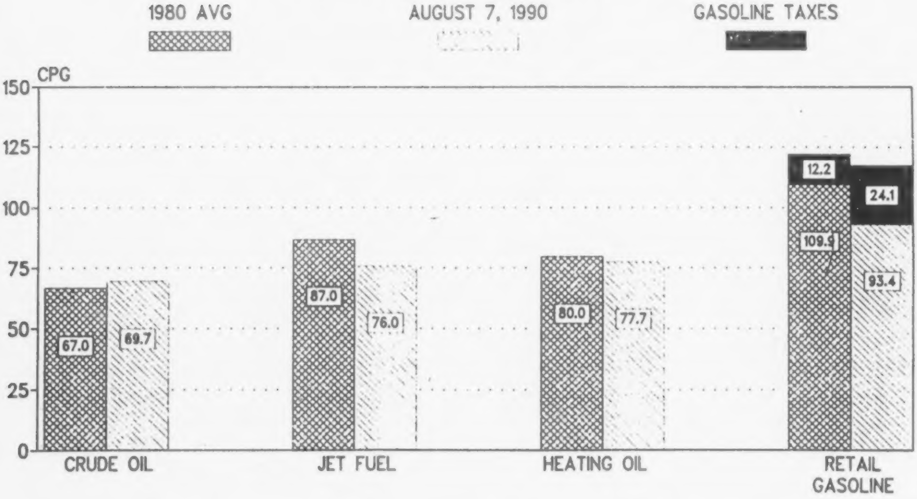


Source: Platt's, Lundberg

CHART #2

CRUDE AND PRODUCT PRICES

1980 Avg vs August 1990

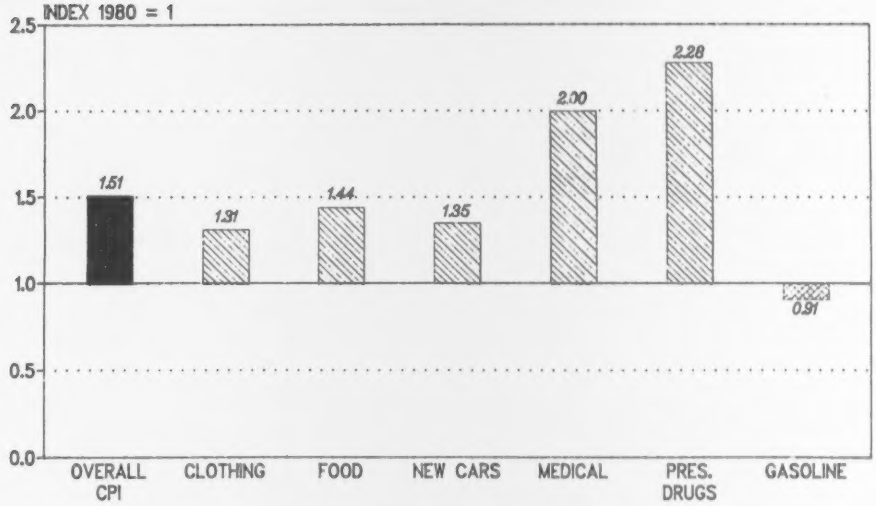


Sources: EIA; Platt's; U.S. Federal Hwy Admin.; Commerce Clearing House, Inc.; Shell Estimates

CHART #3

CONSUMER PRICE INDEX

1989 vs 1980

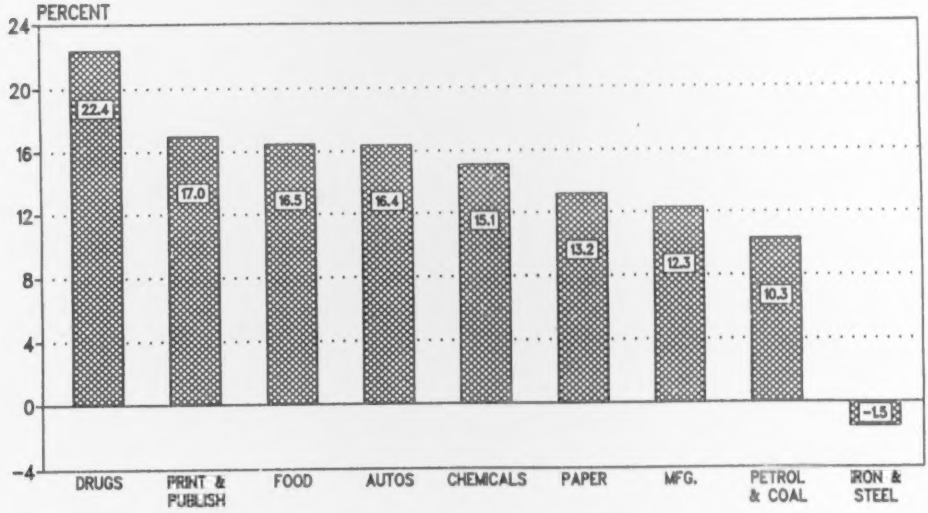


Source: Bureau Of Labor Statistics

CHART #4

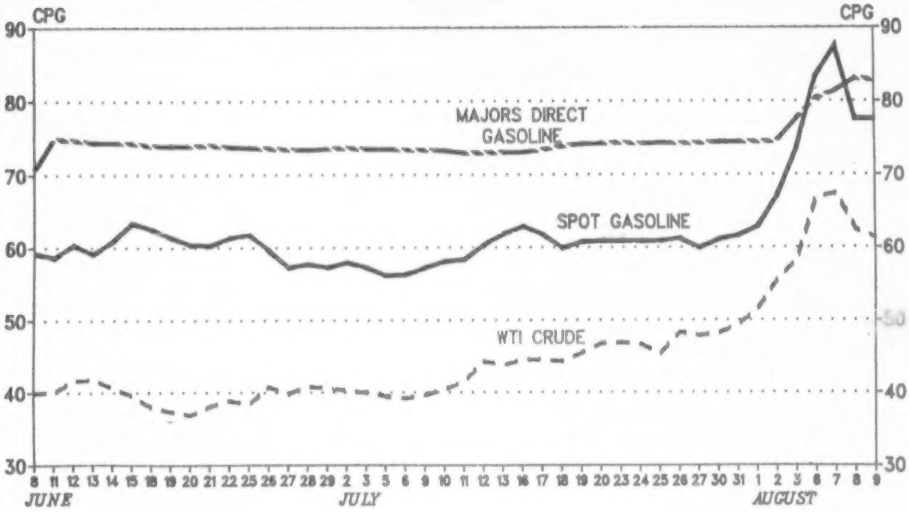
AVERAGE RETURN ON EQUITY

1984 - 1989



Source: Bureau Of Census

CHART #5
REGULAR UNLEADED GASOLINE AND CRUDE PRICES
1990



Source: Platt's, Lundberg

STATE OF IDAHO
OFFICE OF THE ATTORNEY GENERAL
BOISE 83720

JIM JONES
ATTORNEY GENERAL

TELEPHONE
(208) 334-2400

August 8, 1990

The Honorable Richard H. Bryan
Chairman
Consumer Subcommittee
Senate Committee on Commerce,
Science and Transportation
Suite SD-508
Senate Office Building
Washington, D. C. 20510

Dear Senator Bryan:

I applaud you for holding the August 7 hearing on the skyrocketing price of gasoline and diesel. Congressional scrutiny in this area is long overdue.

The current situation bears much resemblance to the grounding of the Exxon Valdez. The major oil companies have seized on a well-publicized event to send their prices through the roof. The gigantic price increases charged to wholesalers were not justified by the Valdez incident and they do not appear to be justified by the situation in the Middle East. In both instances it would appear that public statements issued by the major oil companies have predictably and effectively helped to fuel dramatic price rises on the commodity exchanges and panic buying by folks in the distribution system.

The companies have benefitted by obtaining presumptive justification for jacking up prices on their products, wherever their origin. Many companies benefit from increased profits reaped by OPEC nations by virtue of production or marketing agreements they have with those countries, such as the Saudi-Texaco arrangement. Additionally, the domestic producers reap huge profits by riding the market upward even though it doesn't cost a dime more to produce oil in Texas, Alaska or other domestic locales.

It is certainly appropriate for Congress and the Administration, particularly the Justice Department, to explore the recent price increases to see whether justification can be provided by the oil companies. I seriously doubt that the price increases can be justified by supply-demand factors.

However, the federal government must take a close look at the basic structure of the oil industry to see whether we have permitted too much concentration and vertical integration in that industry. In my estimation we have permitted too much concentration in the industry so that too few people are making the pricing decisions that we all must live with. Both Congress and the Justice Department should take a long hard look at the present structure of the oil industry and consider remedial measures to insure more equitable pricing practices.

Additionally, close scrutiny should be given to the vertical integration that has taken place in the industry in recent years. Both the major oil companies and the oil producing nations have secured market positions which give them control from the oil fields (domestic and foreign) to the gas pump. When we talk about OPEC we say "they" are taking the American public for a ride. However, "they" include many of the oil companies headquartered in the United States. Congress and the Administration should explore the part that our oil companies play in pricing and supply decisions made by OPEC members. Can it be that Texaco plays no part in supply and price decisions made by Saudi Arabia in OPEC meetings? I would submit that many of the OPEC ministers receive input or direction from our major oil companies. If so, it constitutes a form of collusion by proxy that should not be permitted to continue.

Your committee is to be commended for calling upon the President to jawbone major oil companies into providing fair treatment of America's motoring public. I know that type of action can be successfully utilized, having done so myself on a smaller scale here in the state of Idaho. On a number of occasions my office has been successful in calling upon wholesalers and retailers to give motorists a break on the price of gasoline. I am pleased to see that the President has done so to a degree.

However, I think it is incumbent on the Congress to conduct an in-depth inquiry into the pricing practices of the major oil companies, as well as the basic structure of the oil industry in the United States, which I consider to be insufficiently competitive. Additionally, the U.S. Department of Justice should conduct an investigation to determine whether pricing decisions in the last year and a half have been influenced by collusive practices. That would include an inquiry into the part that major oil companies play in decisions made by oil producing nations with regard to prices and supply.

My interest in this subject has been of long standing. When prices started rising earlier this year in the state of Idaho, despite the fact that world crude oil prices were declining, I wrote five of the major oil companies that provide product to the state of Idaho to find out why. I received replies from Texaco, Amoco, Shell, Chevron, and Sinclair. Copies of those replies are enclosed. Quite frankly, I wasn't convinced then and I am not convinced now that those price increases were justified by market conditions.

On May 14 I wrote to congressional leaders and the U.S. Attorney General to ask that an inquiry be conducted into the oil industry. I have yet to receive a reply from the leadership of either party in either house. I did receive a reply from Jim Rill, chief of the Anti-Trust Division in the Justice Department, indicating that action might be taken if I could supply proof of collusion. It is unrealistic to think that any individual state, or even any combination of states, can marshall the resources to conduct an investigation of the major oil companies' pricing practices or the structure of the oil industry. That will need to be done at the federal level and it is something that will take a major commitment of time and resources. Proof just doesn't sit on the surface waiting for the Justice Department to stumble over it.

With the renewed interest in gasoline and diesel prices across the country, perhaps the time is right to get to the bottom of it. I would strongly urge that your subcommittee use whatever resources may at its disposal to bring about an appropriate congressional response to this serious problem, including an in-depth congressional investigation and pressure upon the Justice Department to initiate a meaningful inquiry. The oil-consuming public deserves it and I expect that they will increase the vigor of their demand for it as prices continue to move into the stratosphere.

I would much appreciate it if this letter, including the attachments, could be made a part of the record for your August 7 hearing.

With thanks and best wishes, I am,

Sincerely,

JIM JONES
ATTORNEY GENERAL